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Government
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Canada
Brief to the Royal Commission on
Banking and Finance

[*Submissions*]

Submitted by



THE TORONTO STOCK EXCHANGE



AUGUST 1962



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F O R E W O R D

The Toronto Stock Exchange greatly appreciates the opportunity of presenting a brief to the Royal Commission on Banking and Finance.

In the preparation of the document, the Exchange has had the benefit of papers on the various subjects which were prepared by a number of members, their associates and employees. This material was then edited and collated by the Exchange staff, and scrutinized by a committee of the Board of Governors.

Finally, a resume of the statements of policy, suggestions and recommendations which are contained in the brief was submitted to the members at a meeting called for that purpose.

In general, there was unanimity of approval by the members; however, as one might expect in an organization of this kind, there was a small minority who expressed some difference of opinion with respect to some of the proposals. None of this minority expressed a desire to submit or have submitted to the Commission contra proposals either in writing or orally.

The Commission will find that most of the topics suggested by their Secretary for inclusion in the brief have been dealt with; there were a few, however, which the Exchange considered were outside its sphere of action and felt that, with respect to these, it could contribute little or nothing that would be helpful to the Commission.

All of which is respectfully submitted.

A handwritten signature in dark ink, appearing to read "Howard D. Graham". The signature is fluid and cursive, with a long horizontal line extending to the right.

H. D. GRAHAM, President
THE TORONTO STOCK EXCHANGE

July, 1962.

SUMMARY, SUGGESTIONS
AND RECOMMENDATIONS
(Suggestions and Recommendations are Underlined)

CHAPTER I:

Para. No.
in Brief

1. The chief function of a Stock Exchange is to facilitate the purchase and sale of shares as between investors. 2
2. The major contribution which a Stock Exchange makes to the well-being of the community is that of liquidity. Through the gathering of all available "bids" and "offerings" in one place, holders of shares listed on the Exchange are assured of the maximum liquidity obtainable in such shares. 3
3. This liquidity tends to broaden ownership of shares, and this, in turn, increases the ability of a public company to raise funds. 3
4. Authorized membership of the Toronto Stock Exchange is 113; there are 113 seats. 8
5. Applications for membership are first approved for submission to the members by the Board of Governors. The members then vote by secret ballot. 11
6. The Toronto Stock Exchange is of the opinion that the appointment of a Chief Executive Officer from outside the industry contributes greatly to the public interest and that the appointment of "public" governors is unnecessary and would serve no practical purpose. 22
7. The development of a "national" Stock Exchange or pre-eminent market should be an evolutionary process. Whether this would ultimately involve one, two or more Exchange floors in one or more cities is not yet clear, but it would appear at present that the operation of more than one floor is impractical. The Toronto Stock Exchange believes that its own relative stature among Stock Exchanges in Canada will at least be sustained in the future, and that it can, and will, play a vital role in the emergence of any "national" Exchange in due course. 28

8. Public and Press Relations policy is based on the principle of educating the investor. 32

CHAPTER II:

9. Economic developments in Canada have affected the organization of security industry by creating trends to incorporation; to integration; to geographical distribution; to more complete service for investors; to a slight dispersion of trading volume; and to increased financial stability. 40 41 - 42 43 44
10. Study is being given to the possibility of extending memberships beyond the present limit of 113, but there is no assurance at this time that this may be brought about. 46
11. The business of brokers is a highly personalized one, and the character, personalities and abilities of the principals are of primary importance in competition as between members. 49
12. The Exchange believes that a high degree of harmony and co-operation exists between the leading securities organizations in Canada, and that this state of affairs will not only continue but improve with experience on the part of all concerned. 51
13. The cost of handling an individual order, from the time the ticket to buy or sell is written out until delivery of the securities is completed, varies widely from firm to firm; so many factors are involved that efforts to establish an average have proven unsuccessful. 54
14. The Province of Ontario, since 1911, has imposed a tax on the transfer of securities, with some exceptions. The Exchange acts as an agent for the Province in collecting the tax on securities sold on the Exchange. 56
15. The Exchange considers that whether or not a member firm's financial statement is made public is a matter for the firm itself to decide. 57

16. The Exchange considers that the present policy which permits the same firm to perform the function of both broker and underwriter is well administered, that it is not against the public interest and that there should be no change in the present policy.

59

CHAPTER III:

17. Personnel of a member firm can be considered under the following categories: (a) Sales, (b) Research and Analysis, and (c) Trading and Clerical. 61
18. Customers' Men - number employed - 746; Salesmen) 62(a)
employed - 869; Others who are registered to deal) 62(b)
with the public - 356; Mutual Fund Salesmen - 67;) 62(c)
Floor Traders employed - 373.) 62(d) - 70
- Total employed in the industry, including partners and directors - 4,543. 72
19. The Ontario and other Securities Acts provide for the registration of persons who may deal with the public, but none of the Acts specify any qualifications. The Exchange, with some other Canadian Exchanges, specifies that the employment of such persons must be subject to the approval of the Exchange, and 63
that approval may be revoked. The Exchange sets an examination which must be passed by such persons. 64
20. Members are responsible for the acts of their employees - and no employee is permitted to handle discretionary orders or accounts. 65

CHAPTER IV:

21. The relationship between members of the Exchange and their clients is a personal one in the nature of a trust. 74
22. The Ontario Securities Act prescribes the conditions under which members of the Exchange and their employees and agents may solicit business from the public. 75
23. Under the By-Laws of the Exchange, advertising by

- members is carefully regulated. 78
24. There is no precise statistical evidence of the extent of share ownership in Canada, or of the occupational characteristics and income levels of individual shareholders. It would be useful to have such information and it is suggested that the Dominion Bureau of Statistics might gather it together on a quinquennial basis. 79
25. The Toronto Stock Exchange permits the purchase of stock on a margin of 50% of the purchase price provided its price is over \$1.00 a share, and this percentage must be maintained at all times. 87
26. There has been nothing to indicate that regulations concerning margin beyond those now imposed and exercised by the Exchange itself are necessary. 89
27. The Toronto Stock Exchange considers it is potentially dangerous to encourage investors - particularly new and small investors - to buy stock on a time payment plan. 92

CHAPTER V:

28. Factors which affect the share prices of a company are: State of the industry of which the company is a part; earnings record; management; trend in working capital and cash flow; and psychology of the investors. 102
29. The growing practice of "saving" through the use of "institutions" is seen in the growth of Pension Funds, Mutual Funds and Life Insurance. 105
30. Many Pension Funds have adopted a policy of dollar averaging - thus creating a steady demand for equities and giving some stability to price levels. 106
31. Mutual Funds have become the greatest source of demand for equities amongst all institutional buyers. 109
32. Experience has shown that institutions are well

Para.

- qualified as investment managers and are not the disturbing factor on market activities that many observers believe them to be. 111
33. Non-Resident Owned Funds have lost much of their popularity because of proposed changes in U.S. tax laws. If these proposals are carried through, U.S. investors may liquidate large holdings of Canadian equities. However, action already taken by many N.R.O. Funds should reduce selling pressure in the Canadian market. 112
34. The proportion of assets of Insurance Companies invested in common stocks is very small and well below the statutory limit. 113
35. The traditionally conservative attitude of Canadian investors has had the effect of limiting participation in new or unseasoned issues. 114
36. The proportion of Trust Company assets invested in equities is very modest. 118
37. There is a paucity of statistical information available as to the investment of funds administered by Trust Companies, and it might be helpful if more information could be made available concerning such investments. 119
38. For several past years, there was on balance an inflow of funds from international transactions in Canadian stocks. This trend has been reversed in 1962 when, in May alone, foreigners sold to Canadians a net of \$15,300,000 in Canadian stocks. 121(b)
39. At the present time, the stock Exchange does not recommend any change in investment activities of Pension and Mutual Funds, but a weakness in the selling practices should be corrected. 124
40. The Toronto Stock Exchange believes that it is desirable for Canadian stock ownership to be broadened and that a downward revision of the

present tax structure is necessary to strengthen
the economy and encourage new investment in Canada.

The importance of foreign capital in contributing to Canada's post-war development cannot be overlooked, and, if the country's development is to continue at an appropriate rate, foreign capital in large amounts will continue to be a necessary requirement. To assure that it will be available, confidence in the future of Canada and its monetary and fiscal policies must be restored and maintained. 124(a)

41. The Toronto Stock Exchange believes that the entire
taxation structure in Canada should be the subject
of government review in which every consideration
is given to reducing the burden of taxation now
imposed on corporate or individual taxpayers OR to
designing a new formula for taxation which would
tend to encourage corporate financing through stock
issues rather than by bond issues. 142

42. At the end of 1961, there were 1,117 stocks listed on the T.S.E. with a market value of over \$61 billion; during 1961, more than 719 million shares traded with a value of over \$2½ billion. 143

43. An increase in the supply of equities of Canadian
subsidiaries of foreign-owned corporations should
be encouraged in ways which will be beneficial
both to the corporations concerned and to the
Canadian investors. Care must be taken to ensure
that any encouragement or inducement to increase
supply from this source by legislative action is
not interpreted as punitive and thus result in
impeding the flow of capital into Canada. 146

44. The Exchange recommends that a study be made of
incentives, to include tax incentives, designed to
encourage the distribution and ownership of
equities by all types of investors in Canada. 150

44(a). The Exchange has been urging listed companies to "split" their shares in order to keep their price at or below \$20.00 per share. It is suggested that the Bank Act be amended to permit banks to have their shares of nominal or of no par value and thus permit them from time to time to split their shares. It would probably be helpful, also, in this respect if the Commission would indicate the advantages (if they agree there are advantages) to the companies and to the public in having shares divided from time to time to permit them to sell in the range of \$20.00 or less.

151 (A)

CHAPTER VI:

45. The Exchange facilities can handle up to 21,500 daily transactions; there are 411 T.S.E. tickers in 76 towns and cities in Canada and in 5 cities in the U.S.A. The dial quote system has handled up to 75,000 inquiries per day.
46. Orders for the accounts of customers have priority over all other orders executed on the trading floor. "Orders for accounts of customers" does not include an order for an account in which a member or a partner, director, officer, shareholder or employee of a member has an interest, direct or indirect, other than an interest in a commission charged.
47. A "professional" may be defined as a person who buys or sells for the short term - as a practice - or consistently - and not only on rare occasions. The professional may have a stabilizing influence on the market. Some members of the Exchange do professional trading, but there are no statistics available to indicate either the amount or the profits, if any, from such operations.

152-3-4

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48. Mining and junior oil stocks still have an important, but in recent years a declining, influence on the Toronto Stock Exchange due, in part, to the development here of a large industrial market. But Toronto should continue to hold a pre-eminent place as a mining and oil share market relative to other Exchanges in Canada. 173

CHAPTER VII - Part I:

49. As a result of Sec. 41(b) of the Ontario Securities Act, the Toronto Stock Exchange is respon- respon- sible for primary distribution of the shares of companies engaged in mining and oil production. 177
50. The Exchange practice is to list only the issued capital of industrial companies, but to require the 178(a) initial listing and posting for trading of the entire authorized capital of mining and oil companies. 179
51. The efforts of the Exchange to regulate primary financing have been devoted to two principal areas: a) Option and underwriting terms, and b) full disclosure of all material facts. 180
52. The Exchange is much concerned with the arms-length character of a proposed transaction and has recently passed a ruling to limit or control the prices for assets sold by a director, officer or major shareholder to his own company. 186
53. At all times, an underwriter is held to account for the orderliness of the market in the underwritten shares, and he may be penalized if, following distribution, he completely ignores the market for these shares. 188
54. Many people - in fact, many members of the Toronto Stock Exchange - would remove the practice of primary distribution from the Exchange. The

alternative would be primary financing of mining
and oil ventures by prospectus under the direct
control of the Securities Commission. It is quite 191
certain that any method alternative to the present
one would be subject to disadvantages. 194

55. It is doubtful that any public servant, judicial
or administrative, would act more decisively - or
more objectively - or with more experience - or
with greater consideration for the investor - than
do the Governors (of the Toronto Stock Exchange)
and their committees. It is therefore suggested
that the present system of primary distribution be
left as it now is. 195

CHAPTER VII - Part II:

56. The trend to uniformity of legislation (among the
provinces) in the security field is more evident
than in other areas, and there is good reason to
assume that the trend will continue. In recent 198
years, there has been an ever-increasing degree of
liaison and co-operation between the various
provincial commissions or other relevant author-
ities. 200

57. One hears in Canada occasionally the suggestion
that we should have a federal law similar to the
Securities Exchange Act. To justify federal 203
legislation and administration, the problem of
security regulation must be identified as a
national problem. In Canada, this is not the
case. It is in great measure a local problem,
particularly in the matter of registration of
brokers, etc., and can best be dealt with at that
level. 204

58. The work already done in the field of security

legislation has achieved most of the desired results with little or no disruption of normal business and a minimum of expense to the taxpayer or security issuer.

208

59. The Toronto Stock Exchange is of the opinion that a Federal Securities Act is neither needed nor justified, but does suggest that the Federal Government urge upon all Provincial Governments the need for uniform securities laws and similar administrative regulations.

209

60. As to market manipulation, this is something that is extremely difficult to identify and to prove. A comparison of Sections 323 and 325 of our Criminal Code, with Section 9 of the United States Securities Exchange Act, might indicate that our Section 325 should be amended or extended.

The Exchange suggests that the Commission might recommend that the Department of Justice study this subject and, after consultation with Stock Exchanges, Provincial Securities Administrators and others, decide whether or not amendments to the Criminal Code are needed.

209-A-B-C

CHAPTER VII - Part III:

61. The Toronto Stock Exchange is, to a large extent, a self-policing organization, and in para. 211 are set out some of the regulations which the Exchange has imposed upon, and enforced against, its members.

210

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62. It is the policy and determination of the Exchange that its affairs shall be conducted in accordance with the highest principles of ethics as an efficient quasi-public institution.

212

CHAPTER VIII:

63. Listing policy has been under continuous development over the past ten years, and the tendency has been to

- increase the requirements. 214
64. The Exchange does not wish to develop a list of highly speculative industrial issues, but, at the same time, it is conscious of a responsibility to provide a market place for smaller industrial companies - it endeavours to ensure that all companies deserving or worthy of listing will be accepted. 215
65. Proof of consistent earnings is regarded as removing the security from the highly speculative field, but, if an industrial company cannot show consistent earnings, it may still be accepted if it can show net tangible assets of over \$1,000,000 and working capital of \$250,000 or more. 216
66. A mining company may be considered eligible for listing when it has carried out preliminary exploratory work so that it can provide a competent engineer's report recommending shaft sinking, etc. The company must also be able to show cash on hand or a proposed plan to raise sufficient funds to carry out the recommendation. 217
67. In the oil and natural gas field, the policy is to accept for listing companies which have adequate financing and sufficient cash flow to ensure the continued life of the company - say, net cash reserves of about \$200,000, net cash flow of \$25,000 to \$50,000; this would mean net reserves of 750,000 to 1,000,000 barrels of light oil on a 4% annual production rate. 218
68. Of the 1,117 issues listed on the Toronto Stock Exchange on Dec. 31, 1961, 620 were industrial and 497 mining and junior oil stocks. 222
69. With some notable exceptions, Canadian public companies generally seem to fail to recognize their responsibility to shareholders and to see the value a well-informed analyst - and public - plays in fostering new investor confidence in their securities. It is the Stock Exchange's view that it is inconsistent to encourage

- wider share ownership without encouraging more
informative company reporting. 232
70. The Toronto Stock Exchange endorses the recommenda-
tions made by The Security Analysts Association of
Toronto in a brief submitted in 1956 to the Royal
Commission on Canada's Economic Prospects. 234
71. The Toronto Stock Exchange suggests that legislation
be effected under the jurisdiction of the federal
and provincial Companies Acts and the provincial
Securities Acts, establishing a high uniform set
of standards requiring full disclosure of company
affairs, as set out in paragraphs 236 and 237
72. The above recommendations are not new, nor are they
unreasonable demands to be made upon Canadian public
companies. 238
73. As to "take-over bids", it must be appreciated that
the Stock Exchange influence can extend only to
companies listed on the Exchange and there is some
doubt as to the wisdom of imposing a method of
action on such companies which might place them at
a disadvantage vis-a-vis unlisted companies,
including foreign companies. 242 to 245
74. The Toronto Stock Exchange considers that legis-
lative action, probably by amendment of federal
and provincial Companies Acts, is desirable in
laying down a code of procedure to be applicable
to all parties to such "bids" - provided that
enactment of the same code in all provinces and
by the Federal Government should be simultaneous. 246
75. As to unlisted trading, unless it is recognized
that there is an obligation on the part of the
underwriting firms to later provide a market for
the securities placed with the public, an important
part of the mechanics by which capital may change
hands will be missing. 260

CHAPTER I

STRUCTURE OF THE INDUSTRY:

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STRUCTURE OF THE INDUSTRY

GENERAL

1. Stock exchanges are an inherent part of the free enterprise system. Virtually every major country boasting a well developed capital market has one or more stock exchanges among its financial institutions. The London Stock Exchange was organized in 1773 and the New York Stock Exchange in 1817. The first stock exchanges in Canada were organized before Confederation and incorporated in the 1870's.

2. The chief function of stock exchanges is to facilitate the purchase and sale of shares as between investors by bringing together in one place orders from those who wish to buy and those who wish to sell. The price at which a share transaction is carried out on the exchange is determined by these forces of demand and supply in such shares at that time, as represented by the best price which one or more investor(s) is willing to pay (the bid) and the best price which one or more investor(s) is willing to accept (the offering).

3. The major contribution which stock exchanges make to the economic well-being of the community is that of liquidity. Through the gathering of all available "bids" and "offerings" in one place (the stock exchange), holders of shares listed on the exchange are assured of the maximum liquidity obtainable in such shares. Because of this high degree of liquidity, broadened ownership of shares listed on one or more stock exchanges is greatly enhanced and encouraged. In turn, broadened ownership of shares greatly increases the ability of public companies to raise funds through share issues, as and when required. This means of raising capital has been an essential ingredient in the growth of all industrialized nations of the free world.

BRIEF HISTORY OF THE TORONTO STOCK EXCHANGE

4. Until about the mid-19th Century, most manufacturing or commercial enterprises in Canada were relatively small and privately owned. Enterprises which required larger amounts of capital (e.g., banks, railways and trading companies) obtained most of their capital from abroad - primarily England.

5. As the economy (and the need for share capital) grew, the requirement for broader share trading markets (i.e., liquidity) in Canada became increasingly obvious. The Toronto Stock Exchange was founded in 1852 with twelve members. Twenty six years later, the twenty members of the then existing unincorporated Toronto Stock Exchange successfully petitioned for incorporation as The Toronto Stock Exchange, which was created by a special Act of the Legislature of Ontario in 1878. Amendments to the Act were subsequently passed in 1902 and again in 1912, and Supplementary Letters Patent issued in 1941. Reasons for these revisions are given below.

6. In 1908, in response to a similar need for broader trading markets in mining shares, the Standard Stock and Mining Exchange was incorporated in Toronto as an independent organization.

7. In 1934, the 62 members of the Toronto Stock Exchange amalgamated with the 51 members of the Standard Stock and Mining Exchange (under the continuing name of "The Toronto Stock Exchange"), making it the largest stock exchange in Canada - a position which it still retains.

NUMBER OF MEMBERSHIPS AND SEATS
AUTHORIZED, AND HOW HELD

8. Since the amalgamation of the two exchanges, the number of authorized memberships available has remained constant at 113, although there have not always been 113 active members; for example, at present there are 108.

9. Since the amalgamation, there have been 113 seats - one for each membership. Any one member may be permitted to hold up to three seats, but is entitled to only one vote regardless of the number of seats held. When a member is a partner in a member firm or director of a member corporation, his membership and seat under which he has qualified as a member must be made available as an asset of the partnership or member corporation, and available to the creditors thereof. The firm or corporation may have in it more than one member of the Exchange and thereby may have more than

one seat held and available as aforesaid.

10. The sales and prices of seats in the period 1947-1961 are shown in Appendix No. 1.

QUALIFICATION AND ELECTION OF MEMBERS

11. Every applicant for membership in the Exchange must be at least 21 years of age, male, a British subject, and have been in business for at least three months as a stock or bond broker, or employed for at least three months in the office of a stock or bond broker. An application for membership is referred to the Board of Governors for approval and, if approved, is voted upon by secret ballot by existing members. No ballot becomes effective unless at least twenty members cast their votes; one negative vote in each five is required to reject an applicant. Any applicant whose application is not approved by the Board, or who does not obtain the required affirmative majority on a ballot, may re-apply after six months have elapsed. On the New York and London Stock Exchanges, the Governors have full power themselves to elect members.

LOCATIONS OF HEAD OFFICES

12. Of present members, there are 71 with main or their resident offices in Toronto; 13 in Montreal; 9 in New York; 1 in Vancouver; 1 in Winnipeg and 3 in London, Ontario. Many members have branch offices throughout Canada, and some in London, England, and New York.

FLOOR TRADERS ALLOWED

13. For each seat owned, the member may have four traders on the floor of the Exchange plus the member himself, or five traders excluding himself. These traders are known as "attorneys" or "floor traders".

GOVERNMENT, CONTROL AND MANAGEMENT OF THE EXCHANGE

14. The Exchange operates under the authority of a) its Act of Incorporation, b) By-Laws, and c) Rulings. By-Laws become effective through the majority vote of the members at duly

constituted meetings of members, at which 25 members present in person constitute a quorum. Under the By-Laws, the government of the Corporation is vested in the Board of Governors (the "Board"), who in turn have "authority to make Rulings not contrary to the provisions of these By-Laws and to repeal and amend the same from time to time, and such Rulings shall be binding upon members, member firms and member corporations." (By-Law No. 7, Sec. 5).

15. The Board of Governors consists of ten members of the Exchange (elected annually), plus the President (a non-member permanent paid employee of the Exchange). Officers of the Exchange include (i) four (of the ten) members serving on the Board of Governors who are elected to the positions of Chairman, Vice-Chairman, Secretary and Treasurer, (ii) the President (and Chief Executive Officer), (iii) three Vice-Presidents, an Assistant Secretary and a Director of Research (those in (ii) and (iii) are full-time paid employees of the Exchange). An organization chart is shown in Appendix No. 2.

16. None of the members of the Exchange serving on the Board of Governors (including those serving as Officers) receive any remuneration for such services. Meetings of the Board are held regularly on a weekly basis and at such other times as the Chairman may direct.

17. Members of the Board and some other members of the Exchange are members of various Committees as indicated in Appendix No. 3.

SHOULD GOVERNOR BE APPOINTED FROM "OUTSIDE"?

18. The question has been raised from time to time as to the merits of appointing to the Board one or more persons not directly associated with the Exchange. Those in favour hold the view that such appointees might bring an additional degree of objectivity to Board decisions and further serve the public interest.

19. By their nature, matters placed before the Board for decision are more numerous, varied and intimately connected with the day-to-day business of the Exchange than those normally placed before the Board of Directors of a public company. Accordingly,

a more complete understanding and appreciation of the affairs of the Exchange and its members is required in order to intelligently assess them than could be expected from an "outside" member of the Board. In the view of the Exchange, this factor, together with the necessity on the part of Board members to devote a considerably greater number of business hours each week to Board meetings than is usually expected of non-management directors, would appear to place an unfair onus and responsibility on any member of the Board not directly associated with the affairs of the Exchange and its members.

PRACTICE IN THE NEW YORK AND
AMERICAN STOCK EXCHANGES

20. Governors from outside the membership ("public" governors) are provided for in the constitution of the above - and perhaps other - exchanges in the U.S.A. and are actually appointed. From the standpoint of public relations, this is probably a good thing, but, as far as can be learned, in actual practice they contribute little to the government or regulation of the exchanges or to the formulation of policy.

21. Rather than by having public governors, it is acknowledged by most brokers that a far more realistic recognition of the quasi-public nature of an exchange's function, and a much more practical way of ensuring an objective consideration of the public interest, is by the appointment of a President and Chief Executive Officer from outside the membership. This the Toronto Stock Exchange believes has been proven in New York and, also, in Toronto, where in early 1961 an "outsider" was appointed.

CONCLUSION

22. The Toronto Stock Exchange is of the opinion that the appointment of a Chief Executive Officer from outside the industry contributes greatly to the public interest, and that the appointment of "public" governors is unnecessary and would serve no practical purpose.

AFFILIATES OF THE T.S.E.

23. Affiliates of the Exchange are two other corporations:

a) The Toronto Stock Exchange Clearing Corporation,
which operates a "clearing house" in the Exchange
premises under the management of the T.S.E.
Through it, accounts are settled and shares
delivered between the members and the Exchange
rather than directly between members.

b) The Toronto Stock Exchange Building Corporation,
which holds and manages real estate used now, or
intended to be used in the future, for Exchange
purposes.

24. The Exchange operates a contributory pension plan for the
benefit of its full-time employees - these numbered 141 (including
twenty in the Clearing House) as at June 1, 1962.

NATIONAL STOCK EXCHANGE

25. Although more than one stock exchange normally exists in
most of the highly developed countries of the world, one exchange
usually predominates in each country and may be referred to as a
"national" exchange. The "national" exchange in the U.S.A. may be
said to be the New York Stock Exchange and, in England, it would be
the London Stock Exchange. A major factor in the development of
these institutions to their pre-eminent position in their respective
countries has undoubtedly been the heavy concentration of financial
institutions (e.g., major banks, insurance companies) in the cities
in which these exchanges are located; e.g., New York has been the
recognized financial centre of the United States, and London the
recognized financial centre of England, for many years. Reasons
for this are varied, but appear to flow from the natural course of
events.

26. In Canada, developments have been somewhat different. In
the early years, a substantial portion of the capital necessary for
Canada's growth was imported from Europe (particularly England).
It has been estimated that by the beginning of World War I, approxi-
mately 75% of (direct and indirect) foreign investment in Canada was
British and only about 20% was U.S.* Thus, the importance of

... 7

* Source: "American Capital and Canadian
Resources" by H. C. J. Aitken - p. 36.

Europe as a source of Canadian capital inflow, the relative slowness (by modern standards) of transportation and communication, the earlier settlement of Eastern Canada, and the geographical location of Montreal, all contributed to making that city pre-eminent in Canadian financial affairs in the 19th and earlier years of the 20th Century.

27. In the past several decades, the United States has replaced Europe (particularly England) as the major source of Canadian capital inflow. For example, it has been estimated that in the period 1939 to 1958 the U.S. was the source of about 85% and the U.K. of about 5% of Canada's capital imports.* This factor, together with more rapid means of transportation and communication, and the westward development of the Canadian economy, resulted in the rise of Toronto to vie with Montreal as the financial centre of Canada. This is not the proper platform to argue the relative merits of Toronto and/or Montreal as the country's financial centre, but, with respect to the Toronto Stock Exchange, suffice it to say that in the past three calendar years an average of 68.7% of the dollar value of trading on all stock exchanges in Canada has been conducted on that Exchange and 70.2% in 1961 alone. Figures for all stock exchanges and for the Toronto Stock Exchange for each of the years 1946, 1951, 1956 and 1959-61 were as follows:

<u>Year</u>	<u>Total Value of Trading on all Stock Exchanges in Canada</u>	<u>Value of Trading on Toronto Stock Exchange</u>	<u>T.S.E.% of Total</u>
1946	\$1,233,463,000	\$ 748,742,061	60.7%
1951	2,070,159,696	1,174,246,660	56.7
1956	3,774,604,550	2,510,751,759	66.5
1959	2,816,949,344	1,860,422,327	66.0
1960	1,749,431,069	1,223,330,494	69.9
1961	3,596,536,416	2,526,349,869	70.2

In share volume in 1961, 66% of the total industrial sales in Canada and 76% of mining and oil sales were made on the Toronto Stock Exchange.

28. The development of a "national" stock exchange or pre-eminent market should be an evolutionary process. The Toronto Stock Exchange

... 8

* Source: "American Capital and Canadian Resources" by H. C. J. Aitken - p. 54.

feels that factors at work in the Canadian economy at the present time are likely to lead eventually to the emergence of one such pre-eminent exchange in Canada. Whether this would ultimately involve one, two or more exchange floors in one or more cities is not yet clear, but it would appear at present that the operation of more than one floor is impractical. However, the ultimate development of a prime stock exchange will never preclude the continuation of many existing (or the rise of new) "regional" stock exchanges to fulfill functions of a regional character. The Toronto Stock Exchange believes that its own relative stature among stock exchanges in Canada will at least be sustained in future and that it can, and will, play a vital role in the emergence of any "national" stock exchange in due course.

29. To some persons it seems wrong and against the public interest to permit one Exchange to gain a pre-eminent position. The reverse is the case - a multiplicity of trading places leads to a dispersion of orders, a consequent thinner market and, as a result, greater spreads between bids and offerings. Furthermore, the more trading places, the more the cost per transaction in operation. The cost of modern electronic equipment alone, to afford prompt and efficient quotation, record keeping and other services for members and, through them, to the public, is staggering and requires large volume in one place to justify the necessary expenditures.

30. The Exchange believes that it has an important role to perform in Canadian investment affairs and that its relative importance will not diminish in future years. It is also keenly conscious of its responsibility to the public generally and that its future growth and development will depend upon the maintenance of a high standard of ethics among its members.

31. A comparison of trading in securities interlisted on the Toronto, New York and American Stock Exchanges (Appendix No. 44) would suggest that important competitors of the Toronto Stock Exchange are American exchanges, as some Canadian companies have

sought listings there. A national exchange in Canada would, it may be assumed, provide stronger competition than is provided by the "splitting" of Canadian trading between two or more exchanges (See Appendix No. 45).

PUBLIC AND PRESS RELATIONS

32. The publicity policy of the Exchange is based on the principle of educating the investor, and, at present, approximately \$60,000 per year is spent directly on such a programme. For example:

(a) Last year and again this year, a booth has been operated at the Canadian National Exhibition in Toronto. A new film strip will be shown this year to depict and explain types of investments, how orders are executed, etc. Volunteer employees from member firms are present to answer questions and explain Exchange procedure. Some informative literature is available (two samples are at Appendix No. 37). Several hundred thousand visitors showed great interest in this C.N.E. display.

(b) In 1961, a small magazine was started - The TSE Digest (sample at Appendix No. 38) - which is proving more popular with each issue; there are ten issues a year and the size is being increased.

(c) A modest programme of newspaper advertising is being carried over the term of the year in the principal daily, weekly and college papers in Canada (sample ad. at Appendix No. 39).

(d) A new coloured motion picture - 24 to 26 minutes - is being produced for showing or loan to interested groups across Canada. In 1952, at the time of the Exchange's centenary, a film was made and has been seen by several million viewers, but is now out-of-date.

(e) For the first time in 1962, an Annual Review of the Exchange's activities in the previous year was produced (copy at Appendix No. 40).

In all advertising, emphasis is placed upon the necessity of investors having a financial status which justifies their purchase of equities. They are warned that there is an inherent and varying element of risk in all equities and that they should buy only after careful consideration and after advice from an experienced member of the Exchange.

INDICES

33. In addition to providing the press with bid and ask quotations, total sales, etc., the Exchange compiles and issues four indices each hour that the market is open and seventeen quoted market indices monthly. A new set of indices is now in course of preparation and is expected to be available in the Autumn of 1962.

DAILY BULLETIN AND MONTHLY REVIEW, RADIO, ETC.

34. A daily bulletin, showing all sales, bid and ask quotations and other useful information, is sent to all members and is also available to the public by subscription (copy at Appendix No. 41). A Monthly Review is also issued (Appendix No. 42). Charts are provided to the press, and market summaries prepared for Reuters and other foreign news services. The Exchange does a daily radio broadcast in which 35 stations across Canada participate.

VISITORS TO THE EXCHANGE

35. An estimated 25,000 visitors came to the public galleries of the Exchange last year; here, a tape recording of the trading process may be heard on ear-phones, and there is also a visual animated chart showing the course of action from the time an order is given until it is executed. Conducted groups of school children, service clubs, etc., are shown over the Exchange premises. On occasions, evening trading demonstrations are put on for interested groups. Each year, a group of eight to ten university professors are guests of the Exchange and learn of its operations through talks by the executive staff and a visit to the floor, etc.

FINANCING THE EXCHANGE OPERATIONS

36. (a) The cost of operating the Toronto Stock Exchange is met by receipts from the following sources:

Total Fiscal Year
Ending 31st March, 1962

Members' assessments, as determined from time to time by the Board of Governors. (Fiscal year 1961 - 1962, \$300 per member)	\$ 33,900
Attorney fees. A charge of \$12 per month for each member's attorneys on the floor.	51,312
Clerk fees. A charge of \$5 per month for each member's clerk on the floor.	3,310
Telephone booth. A charge of \$35 per month for each member's booth on the floor.	41,772
Ticket charge. A charge of 9½ cents to each member for each transaction on the floor.	276,823
Curb trade charge. An additional charge of 5% of the regular commission rates on each trade made by members in stock traded on the Curb Section. (now eliminated)	41,795
Fines and entrance fees. Charges levied on members on transfers of seats, fines for infractions, etc.	32,030
Transfer tax commission. A commission paid by the province on transfer taxes collected by the Exchange.	54,594
Ticker commissions. A commission paid by the Canadian National Telegraph on all tickers in service.	68,342
Interest on investments and other income	60,594
Listing, filing and sustaining fees (See Note)	379,187
	<hr/>
	\$1,043,659

Note: As the revenue from listing fees and filing fees is subject to considerable variation from year to year, only 10% of these fees when received are taken into current revenue and the balance placed in a special reserve of which 10% per annum is also brought into current revenue. Thus, listing and filing fees are being amortized on a ten year basis. Had listing and filing fees been taken into revenue as received, this figure would have been shown as \$515,491.

(b) The Exchange being a non-profit organization, the various charges to its members by assessment and otherwise are calculated to meet operating expenses each year and to permit the setting aside of such reserves as may be considered prudent to meet future requirements.

Such future contingencies are possible periods of reduced revenue when the incomes of the membership might also be reduced and large-scale expenditures for new equipment which, based on past experience, will be required from time to time. As intimated later in this brief, it is expected that new quotation equipment will be installed in the early future and in addition increased accomodation must be provided.

(c) Hereunder is a statement of Exchange expenditures for the year ending March 31, 1962.

STATEMENT OF EXPENSES

For the year ended March 31, 1962

Exchange

Salaries	\$439,017.57	
Telephone and telegrams	13,396.49	
Ticker service	10,317.50	
Audit fees	2,000.00	
Exchange auditor	13,800.00	
Law costs	11,562.75	
Pension plan	27,825.92	
Advertising	23,315.02	
General expense	46,440.05	
Printing, postage and stationery	34,127.27	
Business taxes	30,324.70	
Teleregister maintenance	15,293.46	
Unemployment insurance	4,190.39	
Employees' hospital plan	3,914.40	
Business machine rental and expense	74,922.19	
Rent	9,694.06	
Employees' benevolent fund	15,000.00	
Monthly Review	11,842.05	
TSE Digest	4,261.59	
Sundry travelling	14,019.33	
Special travelling	10,585.15	
Research and new processes	<u>16,629.50</u>	\$832,479.39

Buildings

Realty taxes	\$ 59,230.83	
Fuel	2,442.35	
Insurance	3,963.77	
Laundry	1,177.09	
Light	7,003.68	
Maintenance and repairs	27,914.51	
Power	4,084.90	
Janitor's supplies and services	24,856.91	
Wages	36,898.11	
Water	3,214.68	
Pension plan	3,916.14	
Excess expenses, 226-230 Bay Street	<u>4,773.39</u>	\$179,476.36

\$1,011,955.75

CHAPTER II

MEMBER ORGANIZATIONS - TRENDS - COMMISSIONS, ETC.

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TRENDS IN THE DEVELOPMENT
OF MEMBER ORGANIZATIONS

37. The changes which have occurred in the activities of security dealers in Canada in general, and of the Toronto Stock Exchange members in particular, in the years since World War II must be viewed in the light of economic developments in this country during the same period.

ECONOMIC DEVELOPMENTS AFFECTING MEMBERS

38. The more significant of these developments in relationship to the Canadian securities industry would appear to be:

- (i) population growth;
- (ii) sporadic but general increase in national income (total and per capita);
- (iii) discovery and development of natural resources (e.g., petroleum and natural gas in Western Canada, uranium in Ontario and Saskatchewan, iron ore in Labrador, etc.);
- (iv) large capital requirements by various sectors of the economy (Seaway, pipelines, etc.), both public and private;
- (v) increasing institutionalization of savings for investment purposes (e.g., insurance companies, trust companies, pension funds, mutual funds);
- (vi) development of more rapid means of transportation and (particularly) communication;
- (vii) growth in interest in Canadian securities on the part of foreign (particularly U.S.) investors and some tendency in recent years for a growth in interest in foreign securities among Canadian investors;
- (viii) changes in personal income taxes, particularly in the area of graduated tax rates and dividend tax credits;

(ix) improving knowledge of actual and potential investors in investment matters.

39. With respect to many of the items cited above, the role of the securities industry has been an active one. In others, it has been one of response to the challenges and opportunities which have resulted. The effect of these and other stimuli on members of the Toronto Stock Exchange is reflected in the following broad developments:

TREND TO INCORPORATION

40. (a) Until the early 1950's, membership in all stock exchanges in either the U.S. or Canada was restricted to sole proprietorships or partnerships. In 1953, the New York Stock Exchange permitted incorporation on the part of its membership. In December 1953, the Toronto Stock Exchange passed By-Law 67, which permitted incorporation of its membership as of January 1, 1954. Simultaneously, audit requirements to adequately safeguard the interests of both clients and other dealers under the new circumstances of limited liability were sharply increased.

(b) Effect of Income Tax Policy - Introduction of By-Law 67 was a recognition on the part of the Exchange of a number of the factors referred to in para. 38 and their impact on the business affairs of Exchange members. Chief among these was the difficulty of many members, under the incidence of graduated personal income taxes, to retain in their unincorporated businesses a sufficient portion of their earnings to finance their growing capital requirements. A high level of retained earnings (plough-back) has been an essential ingredient in Canadian business expansion in post World War II years. It has been of particular significance to members of the Exchange.

(c) Effect of Exchange Regulations - Under Exchange regulations, every partner of an unincorporated member and

every holder of voting shares of an incorporated member must be either an officer or an employee of his member organization actively engaged in the business (or of an affiliated company) - unless he is in active government service or his health does not permit - and devoting the major portion of his time thereto. Although this regulation was deemed by the Exchange a necessary means of ensuring a high degree of control over the affairs of its membership, it was also a restrictive one in terms of sources of capital for member firms. Thus, to provide long-term capital to meet the financial needs of an expanding securities industry in an expanding economy, member firms have had to rely upon (i) the personal financial resources of active participants in their organizations, (ii) retained earnings.

(d) Earnings Invested in Business - The greater ability to plough back earnings, which, since 1954, might be done if incorporated, is undoubtedly responsible for the sharp increase in corporate membership in recent years (see below).

<u>Type of Organization</u>	No. of TSE Member Organizations as at January 1st			
	<u>1947</u>	<u>1952</u>	<u>1957</u>	<u>1962</u>
Sole proprietorship	18	10	8	4
Partnership	75	88	50	46
Corporation	<u>0</u>	<u>0</u>	<u>41</u>	<u>48</u>
Total No. of Organizations	<u>93</u>	<u>98</u>	<u>99</u>	<u>98</u>

(e) Resulting Stability - There can be little doubt that this permissive alteration in form of organization has played an essential part in the rapid physical expansion and greater financial stability which has occurred among Exchange members (and their affiliates) during the past decade, and continuance in the trend to incorporation is expected.

TREND TO INTEGRATION

41. (a) The combination of a number of factors referred to in para. 38 has also led to a high degree of integration on the part of many members of the Exchange. For example, as at January 1, 1949, only 41% of Exchange members were directly (or indirectly through affiliates) members of the Investment Dealers' Association of Canada. As at May 15, 1962, the figure had risen to 74%. Similarly, the direct or indirect association of Exchange members with other security organizations (e.g., Montreal Stock Exchange, Canadian Stock Exchange, Vancouver Stock Exchange, Broker-Dealers' Association, etc.) has shown a rising trend in the post-war period (see Appendix No. 4 for detail, and, for a list of members with financial directorship, see Appendix No. 4(a)).

(b) The Broker-Dealers' Association has a Board of eight Governors, and the Ontario Securities Commission insists that three of these be members of the Toronto Stock Exchange. In 1961, the T.S.E. brought its influence to bear upon the B.D.A. to deter members of the latter organization from using high pressure methods in marketing securities in the United States, having learned that certain deplorable instances were attracting disrepute to the brokerage industry in Canada, in the broad sense.

(c) Ontario Securities Commission - Relations between the Stock Exchange and the Ontario Securities Commission are close and cordial, and require frequent consultations together on many matters of mutual interest where such consultation is helpful although not mandatory. Formal relations pertain to the following matters:

(1) Membership in the Stock Exchange is accepted by the O.S.C. as one of the three self-policing bodies to which a securities firm (with minor exceptions) must belong in order to deal with the public.

(2) Registration with the O.S.C. of securities salesmen.

(3) Registration and filing of prospectus with the O.S.C. of primary placement of certain new issues to the public.

(4) Arrangement for escrowing and subsequent release of blocks of vendors' shares.

Informal relations include among such other matters of joint concern as:

(1) Discussion regarding certain personnel admissions, where acceptance is not automatic.

(2) Conduct and attitude towards their public responsibilities of member firms.

(3) Revoking of registration where other restraint appears ineffectual.

(d) Effect of Diversified Investing - Basic factors behind this high degree of integration and co-operation among members of the Exchange (or conversely among the members of the other security organizations) are many and varied. One has been the post-World War II trend on the part of institutional, corporate and individual investors alike to deal in both debt securities and equities, and the corresponding desire of many security dealers to broaden their services to include both types. Another has been the rapid strides in both transportation and communication, which have greatly facilitated security (debt and/or equity) transactions between various parts of Canada and between Canada and other countries.

(e) Effect of Multi-Membership - Thus, for example, a security dealer based in one part of Canada may, through branch offices, deal with investors in many other areas of the country. Membership on the Toronto Stock Exchange gives him access to a highly liquidable market in a large proportion of Canadian (as well as a few foreign) preferred and common shares. Membership in other exchanges in Canada tends to

supplement the share markets to which he has access and, therefore, broadens the range of the services which he can make available to his clients. Membership on the New York Stock Exchange provides him with ready access to shares listed on that exchange. Membership in the Investment Dealers' Association of Canada provides him with - among other things - access to new issues of certain securities of all classes (bonds, preferred and common shares) which membership in one or more of the other security organizations is unlikely to provide him.

(f) Effect of Broad Investor Interest - The apparent complex relationship of membership in various security organizations among securities dealers - as suggested by the present relationship of members of the Toronto Stock Exchange with other groups - is a natural outgrowth of the broadening investor interest in securities of all class and kind in evidence throughout the Western world in latter years. The significance of this inter-relationship or internal integration is primarily that which typifies the free enterprise system - a desire and a ready response on the part of (the securities) business to meet the demands of the ultimate consumer (investor).

(g) Conclusion: Increased Integration - Increased internal integration may be expected, but perhaps at a slower pace than has been the case in the post-war years. However, if the trend in recent years to a greater interest in Canadian securities on the part of foreign investors, and in foreign securities on the part of Canadian investors, continues, it is possible that greater integration between members of various security organizations in Canada (including the Toronto Stock Exchange) and of security organizations in other countries will take place in the future.

TREND TO GEOGRAPHICAL DISTRIBUTION

42. (a) Head Office Locations - Membership in the Toronto Stock Exchange (as represented by head office location) has materially

broadened in a geographical sense as well, in post-war years.

This is clearly borne out by the following figures:

<u>TSE Member Organization</u>	<u>No. of Organizations as at January 1st</u>			
	<u>1947</u>	<u>1952</u>	<u>1957</u>	<u>1962</u>
Head office in Ontario*	82	80	81	74
Head office in Quebec	5	10	9	13
Head office elsewhere in Canada	1	2	1	2
Head office in U.S.A.	<u>5</u>	<u>6</u>	<u>8</u>	<u>9</u>
	<u>93</u>	<u>98</u>	<u>99</u>	<u>98</u>
* Includes Toronto	78	78	79	71

The impressive increase in T.S.E. member organizations with head offices located in the Province of Quebec and in the United States during the past fifteen years, evident from the above statistics, once more focuses attention on the broadening scope and varying relationship which has typified the securities industry in the post-war years.

(b) Interest in U.S. Securities - Securities markets are no longer of exclusive interest to local investors, or to local securities dealers. Investors living in one area of Canada are interested not only in Canadian securities available locally, but in Canadian securities whose primary markets are located in other areas of Canada. In recent years, they have also shown an increased interest in U.S. securities whose primary markets are located in that country. Similarly, U.S. investors have widened their security horizons to include Canadian securities with primary markets located in various parts of Canada.

(c) Branch Offices - In order to provide as complete a service as possible to investors in various areas, securities dealers have shown a marked tendency not only to add to their facilities (by becoming members of security organizations in other areas), but also to add to their outlets (by opening branch offices in the areas in which the facilities are added). The degree to which investment firms have directly (or indirectly through

affiliates) responded to the widened scope of investor interest in Canada is indicated by the following resume of branch office locations of T.S.E. member organizations as at January 1st, 1962:

<u>Branch Office Locations</u>	<u>No. of TSE Member Organizations as at May 15, 1962</u>
No branch offices	40
Branch offices in Ontario only	23
Branch offices in Ontario and other Canadian Provinces	11
Branch (and head) office in Quebec only	1
Branch offices in Canada and elsewhere	<u>25</u>
Total	<u>100</u>

(d) Conclusion: More Branches Likely - This wide geographical location of Exchange members and their (or their affiliates) head and branch offices reflects not only circumstances peculiar to the members (e.g., ability to incorporate and, hence, more readily finance expansion of their organizations) but also many of the developments in the Canadian economy referred to earlier in this section. More rapid communication is not the least of these. If the trend to broadened interest in securities beyond their immediate markets continues among Canadians (and/or among residents of other countries in Canadian securities), considerable further geographical distribution of Exchange members and/or their branch locations may be expected in future years.

TREND TO MORE COMPLETE SERVICE

43. (a) The preceding paragraphs indicate that the investment industry in Canada has tended to become increasingly complex in the post-war period. This has been a natural response to the growing demands placed on the industry by investors of all classes.

(b) Effect of More Sophisticated Investors - The past several decades have seen a rapid increase in the institutionalization of investor funds in Canada - a development not unique to this country. This growth in what might be termed professional investing has

required an increasing degree of skill and knowledge among members of the securities industry if they are to be competitive in this area. Similarly, individual investors have become more sophisticated as their knowledge of, and experience in, investment matters has broadened. Customers' men and securities salesmen have had to become more knowledgeable, not only about individual securities but also about business conditions, government fiscal and monetary policies, and matters of international significance.

(c) Security Analysts Essential - Security analysis has become an integral part of the fabric of most Exchange member firms. Indicative of this is the fact that in 1961 more than one-half the members of the Exchange had one or more employees enrolled as members of The Security Analysts' Association of Toronto - a group devoted to the pursuit of better investment information. Several members also have employees enrolled in similar organizations in Toronto and other major cities. Few investors today - whether institutional, corporate or individual - are interested solely in one type of security. Debt securities, preferred stocks and common stocks are in varying demand (and supply) under varying conditions. Although employees of member firms are most likely to be oriented toward equities, they must have a working knowledge of (federal, provincial, municipal and corporate) debt securities of various kinds, and of the factors which affect their present and future worth.

(d) Portfolio Analysis - This is closely associated with, and relies to a considerable degree on, security analysis, and has also become an increasingly important tool of security dealers (including T.S.E. members) as a means of matching investor requirements with available securities.

(e) Mutual Funds have become increasingly popular in recent years as investment media for Canadian investors. Although most mutual funds have their own retail sales force, a portion of their sales are derived through various investment firms. The Exchange has no financial statistics on the degree to which its

members participate in this area. It is believed, however, that although in isolated instances the volume of mutual fund share sales may be significant, total sales by members as a whole would represent only a minor portion of Exchange member firm revenues. Similarly, such volume is believed to represent only a minor portion of total mutual fund sales in Canada.

(f) Conclusion: Demands for Service Will Increase - Hence, while the primary function of most members of the Exchange (excluding their affiliated companies) continues to be the day-to-day business of matching purchases and sales of listed shares, the extent of services to clients (suggested above) necessary to conduct such a business has been one of continuous growth. It is probable that the demands on Exchange members - as on other securities dealers in Canada - in this direction will continue to increase in future years.

TREND TO DISPERSION OF TRADING
VOLUME AMONG MEMBERS

44. (a) Slight Dispersion - Available statistics suggest that volume of trading among member organizations (as evidenced by share transactions) has shown some tendency toward dispersion rather than one of concentration in recent years. An analysis of figures over the past ten years indicates that between 1951 and 1961, (i) the percentage of share transactions on the Toronto Stock Exchange carried out by the five leading members remained virtually constant at approximately 23% (or an average 4.6% per member), (ii) the percentage carried out by the next (i.e., sixth to tenth) five leading members declined from approximately 14% (or an average 2.8% per member) to approximately 9% (or 1.8% per member), (iii) the percentage carried out by the succeeding (i.e., eleventh to fifteenth) five leading members increased from approximately 10% (or an average of 2.0% per member) to approximately 12% (or an average 2.4% per member). The fifteen leading members in terms of share trading volume in 1951 were also the same leading fifteen members in 1961.

(b) The percentage of share transactions conducted by the first five, ten and fifteen leading members in the years 1951, 1956 and 1961 are set out below:

<u>No. of TSE Member Organizations</u>	<u>% of Total TSE Trades Carried Out by Leading Members</u>		
	<u>1951</u>	<u>1956</u>	<u>1961</u>
5 Leading Members	23%	22%	23%
10 " "	37	36	32
15 " "	47	47	44

On the basis of these statistics, it would appear that there has been a modest trend to dispersion in terms of share volume of trading among Exchange members. However, the degree of dispersion is not sufficiently great to justify a forecast of the future trend.

TREND TO INCREASED FINANCIAL STABILITY

45. (a) Requisites for Future Growth - Reference has already been made to various trends (incorporation, integration, more complete service, etc.) which suggest that Exchange member firms have been growing in stature in recent years. In part, this no doubt reflects the relative prosperity - in which the Canadian people as a whole have participated - which has existed in this country during the post-war era. More importantly, it reflects the appreciation on the part of most Exchange members that a continuing and constant reputation for (i) integrity, (ii) ability, (iii) financial stability, is the necessary foundation on which to build the long-term future of their organizations.

(b) Evidence of the present financial capabilities of Exchange members may be had from the following breakdown according to size of the gross assets (including a valuation of the seats) as at December 31, 1961, of seventy member organizations:

<u>Gross Assets</u>	<u>No. of Member Organizations As at December 31, 1961</u>
Over \$3,000,000	12
Over \$1,500,000 and under \$3,000,000	16
Over \$750,000 and under \$1,500,000	22
Under \$750,000	<u>20</u>
	70*

* Excludes member organizations otherwise reporting to the Royal Commission on Banking and Finance through other sources.

(c) Conclusion: Tendency to Grow - Given continuance of recent trends among members to incorporation, integration, etc., it seems logical to expect that, in terms of net assets, member firms as a whole will tend to grow in size and stability with the median tending to remain in about the same relative position to the group as a whole.

STABILIZATION OF EXCHANGE SEATS

46. (a) The total number of Exchange seats has remained constant since 1934. A member may hold no more than three seats; a member firm or corporation may have more than one member; one seat entitles the holder to five traders (see paras. 8, 9 and 13, Chapter 1). Accordingly, if the volume of trading conducted by a member firm reaches such proportions that the seat member and four attorneys are unable to handle that volume, the member firm will normally purchase an additional seat from another member.

(b) Distribution of Exchange Seats - As indicated below, the vast majority of member firms usually hold only one seat on the Exchange. Hereunder is set out the distribution of Exchange seats as at January 1st in each of the years 1947, 1952, 1957 and 1962:

<u>TSE Seat Distribution</u>	<u>No. of Member Organizations as at January 1st</u>			
	<u>1947</u>	<u>1952</u>	<u>1957</u>	<u>1962</u>
Member firm holding 1 seat	86	91	88	90
" " " 2 seats	6	6	8	7
" " " 3 seats	1	0	3	0
" " " 4 seats	<u>0</u>	<u>1</u>	<u>0</u>	<u>1</u>
Total member firms holding seats	<u>93</u>	<u>98</u>	<u>99</u>	<u>98</u>
Active Seats	101	107	113	108
Inactive Seats	<u>12</u>	<u>6</u>	<u>0</u>	<u>5</u>
Total Seats	<u>113</u>	<u>113</u>	<u>113</u>	<u>113</u>

There is little indication from the above as to any significant trend to either diffusion or concentration of seats among member

organizations, or as to the relationship between active and inactive seats. Activity or inactivity of seats tends to be related to the current and prospective level of trading activity on the Exchange, which in itself varies widely from time to time.

(c) Authorized Non-Member Brokers - An authorized non-member broker is one who is not a member of the Toronto Stock Exchange but who maintains an office and regularly conducts a stock or bond brokerage business with the public, and who has signed the application and agreement furnished by the Exchange and has been approved by the Board of Governors for split commission privileges.

This category was created when the Exchange recognized that, because of the many factors outlined in paragraph 38, some securities dealers in certain localities in Canada or elsewhere in the world might have an active interest in securities listed on the Toronto Stock Exchange, but the volume they could generate would not warrant the purchase of a seat. Many of these brokers located in Canada may be members of the B.D.A. or I.D.A. of C., although membership in such organizations does not of itself entitle them to the various non-member broker privileges. The split commission privilege entitles the broker to not more than one-third of the regular commission on his orders - the same privilege extended to all member firms of recognized stock exchanges.* While they carry out their exchange transactions through a member firm, these non-members must maintain their own identity and, in effect, stand on their own feet financially and otherwise.

The authorization of a non-member broker may be withdrawn at any time, whereupon he ceases to be entitled to the split commission. This in effect gives the Exchange some control over these brokers and encourages them to conduct their business according to the same standards as the members themselves.

Alternative methods of extending this privilege to this group have been considered in the past, and further study is being given the matter. For copy of non-member broker agreement, see Appendix No. 46.

* Recognized stock exchanges for this purpose at the present time are Montreal, Canadian, Vancouver and Calgary in Canada; all major exchanges in the U.S. and Europe.

INTERNAL ORGANIZATION OF MEMBERS

47. As outlined in earlier paragraphs (40(d)), there is a considerable variance among Exchange members in many directions. About one-half of the members are incorporated, while the remainder conduct their business on partnership or sole ownership lines. A few (8) have no affiliation with any other major securities organization; but most are directly or indirectly affiliated with the Investment Dealers' Association of Canada (73), Montreal and/or Canadian Stock Exchanges (48), Broker-Dealers' Association (25), Vancouver Stock Exchange (10) or New York Stock Exchange (7). Many maintain no branch offices, but the majority have branch offices either in Ontario or elsewhere. However, insofar as the conduct of business associated with securities traded on the Exchange is concerned, most members maintain the following basic departments:

- (a) Trading
- (b) Sales
- (c) Research and Portfolio
- (d) Underwriting
- (e) Administration

At Appendix 5 is an organization chart, which might be considered as the basic skeleton around which incorporated Exchange members build their organizations.

COMPETITION AMONG MEMBERS

48. With respect to the primary function performed by members of the Exchange, i.e., the transaction of purchases and/or sales of securities listed on the Exchange, their businesses are based on "service" to investors whether institutional or individual. Since the same scale of commission rates must be charged by all members, it necessarily follows that success in competition among members for business depends in varying degrees upon such factors as:

- (i) Accuracy and speed of service
- (ii) Quality and quantity of research information

- (iii) Quality of portfolio advice
- (iv) Range of service (i.e., knowledge of and access to various types of securities)
- (v) Financial stability
- (vi) Personal relationships
- (vii) Ability, industriousness and integrity of principals and employees

Because of individual personalities, members vary in the emphasis which they tend to place upon these (and other) factors. Some deal only in industrial and seasoned mining and oil stocks; others specialize in mining and oil stocks. Some concentrate on institutional business, while others specialize in handling individual retail accounts. Some carry no margin accounts, while others do so.

CHANGES IN MEMBERS

49. It is interesting to note that of the 94 member organizations active in business at the end of 1951, twenty were no longer in business ten years later. Of these, four or five might be said to have ceased operations by reason of inability to meet Exchange requirements - financial or otherwise - while disappearance of the others appears to have involved factors which might be regarded as the normal course of events. It is equally interesting to note that of the 98 member organizations in business at the end of 1961, twenty four were not in business ten years earlier. These figures serve to indicate the changing nature of the Exchange membership and support the view that the business of members is a highly personalized one with the character, personalities and abilities of the principals of primary importance in competition as between members.

EXCHANGE (AS OPPOSED TO MEMBERS') RELATIONSHIP WITH OTHER SECURITY ORGANIZATIONS

50. Relevant By-Laws and Rules of the Exchange are applicable to affiliates of members who may belong to another security organization. Thus, an Exchange member who (or whose affiliate) is also a member of (for example) the Investment Dealers' Association of Canada is subject to the regulations of both the I.D.A. and

the T.S.E. This requires a high degree of liaison between the Toronto Stock Exchange and other leading Canadian security organizations. The trend to integration in the securities industry, as discussed earlier, has intensified this need for liaison. This liaison, in turn, has led, in recent years, to an increasing conformity in the regulations of all security organizations with a view not only to maintaining a high standard of ethics and business conduct in the industry generally, but also to facilitating dual or affiliated membership one with the other.

51. The Exchange believes that a high degree of harmony and co-operation exists between the leading securities organizations in Canada, and that this state of affairs will not only continue but will improve with further experience on the part of all concerned.

COMMISSION RATES

52. Changes in the schedule of rates charged have been made from time to time. In July 1960, the present single scale of commissions was adopted in place of the two separate schedules which had previously been used in covering "Industrial and General Securities" and in covering "Mining and Oil Securities". At the time the new schedule was adopted, the rates of commission were reduced substantially on shares trading below \$4.00; other rates generally were left unchanged with some exceptions which resulted in slightly higher rates on mining and oil shares selling between \$4.00 and \$20.00 (see Appendices 34 and 35, and para. 60).

BLOCK TRADING AND SPECIAL COMMISSIONS

53. More recently, the Toronto Stock Exchange, in an attempt to discourage the large amount of block trading being done "off the floor" of the Exchange, passed a By-Law raising the size of "off the board" trades permitted from \$25,000 to \$50,000, and then again from \$50,000 to \$100,000. With the most recent change, the rates of commission which must be charged were also changed so that all transactions must carry one full commission on each side, i.e., two commissions on put-throughs or one commission to each broker where two brokers are involved. Where the profit is expressed as the

difference between net prices, the spread must equal at least two commissions. However, on special-size transactions of over \$100,000 in value, the scale may be reduced to one and a half commissions over-all; on special-size transactions of over \$250,000, the scale may be reduced to one full commission over-all. It should be noted that trades off-the-floor may be made only with permission from the Exchange.

The sharp decline in stock prices has doubtless been responsible for the fact that the volume of block business has declined since the new By-Law has been in force. However, the effect in more stable markets will be watched with interest by the active block dealing firms.

COSTS OF HANDLING TRANSACTIONS

54. The cost of handling an individual order from the time the ticket to buy or sell is written out until delivery of the securities is completed varies widely from firm to firm. So many factors are involved with the many member firms that efforts to establish a satisfactory industry average have proven unsuccessful. It should be pointed out that a great deal of no-profit business has been undertaken by member firms with smaller investors, particularly in the Investment Club category, more as a service in the hope that some day these small investors will become larger investors.

COMPARISON - NEW YORK AND AMERICAN STOCK EXCHANGE RATES

55. The graphic illustration at Appendix 35 shows a comparison of commission rates between the Toronto Stock Exchange and the New York and American Stock Exchanges as a percentage of the price of the stock dealt in. While our rates, in the \$0.15 to \$4.00 range, expressed as a percentage of the price, are much lower than the corresponding rates for the two leading American exchanges, it should be pointed out that the number of stocks trading below the \$5.00 level on both the New York and American Exchanges is considerably less than

in Toronto, where a large number of lower-priced mining and oil issues account for a substantial portion of our volume (in 1961, the value of the average share traded on the Toronto Stock Exchange was \$3.51 - comparable to \$18.65 for the average industrial and \$1.03 for mining and oil stock). Our rates are slightly higher than those in New York for stocks trading between the \$5.00 and \$30.00 level, after which price New York rates are again higher. Canadian rates become slightly higher again in the \$80.00 to \$250.00 range. Consideration has been given in the past to adopting a more flexible schedule of rates which would be more clearly linked to the dollar value of the dealings involved, but this was impracticable because of the large volume of dealings in our lower-priced issued.

SECURITY TRANSFER TAX

56. (a) Ontario and Quebec alone of the provinces impose taxes on the transfer of securities. Apparently, the tax in Ontario was imposed in 1911 simply as a source of additional revenue and not to defray the cost of a particular government agency. The rate is 3¢ on each \$100 par value of bonds and debentures (with some exceptions) and the rate on equities is: $\frac{1}{10}$ ¢ per share under \$1.00; $\frac{1}{4}$ ¢ - \$1.00 to \$5.00; 1¢ - \$5.00 to \$25.00; 2¢ - \$25.00 to \$50.00; 3¢ - \$50.00 to \$75.00; 4¢ - \$75.00 to \$150.00; and, over \$150.00 - 4¢ plus $\frac{1}{10}$ of 1% of value over \$150.00.

(b) The Toronto Stock Exchange acts as "agent" for the Provincial Government and collects from its members the tax payable on sales effected upon the Exchange.

(c) It is estimated that the Province of Ontario tax will have yielded in the last fiscal year \$3,400,000; of this amount, just under \$2,000,000 resulted from transactions on the Toronto Stock Exchange.

PUBLISHING MEMBERS' FINANCIAL STATEMENTS

57. Suggestions are sometimes made that stock brokers should be required to publish their balance sheets as do other financial intermediaries dealing with the public. It may appear that the Exchange is inconsistent and self-indulgent when it urges public companies to improve the quality of their financial reporting while, at the same time, it does not insist upon its members following a similar practice. Such is not the case.

A public company whose bonds or stocks may be bought or sold at any time by the general public has a legal and a moral responsibility to provide the investor with current information as to the state of business of the company in which he has invested. A brokerage firm, however, is a private company with capital provided by only a few shareholders, and there seems no good reason for such a firm (any more than other private companies) to divulge its financial affairs to the public at large. True, it is in a sense a "financial intermediary", but the Exchange, through its strict audit procedure, ensures the financial stability of its members more effectively than would the publication of financial statements.

Therefore, the Exchange considers that whether or not a member firm's financial statement is made public is a matter for the firm itself to decide.

SEPARATION OF UNDERWRITING FROM BROKERAGE

58. In connection with the various functions of member firms, it has been suggested that the investing public might be better served if the underwriting and the brokerage operations of a company were segregated from each other. This would presumably require many firms now engaged in all phases of the business to set up one company for underwriting and another for the brokerage business. In many cases, this has already been done by a number of firms who have formed "affiliates", although, of course, in these cases, there is usually an identical ownership - and it should be noted that many of the Exchange regulations apply to such affiliation.

59. There may be a small area of conflict where underwriting, distribution of new issues and brokerage transactions take place within the same firm. However, this would appear to be more than offset by the advantages which an integrated firm possesses in the form of experience and knowledge of markets obtained through direct contact with the investor, on the one hand, and the company issuing securities, on the other hand. A meeting of minds takes place

within the same firm rather than between two or possibly several firms. Separation of the underwriting, distribution and brokerage facilities of the industry would inevitably increase the cost of handling securities. The research, statistical, delivery and other services now customarily provided by an integrated firm would have to be duplicated by firms engaged in each segment of the industry. Even in the United States, where extreme measures have been taken to protect the public (often ineffectually), it has not been considered practical or prudent to separate the investment community into arbitrary compartments. Members of the stock exchange take care to differentiate between securities which they may own and are reselling to clients as principals and/or the purchase and sale of securities strictly on a brokerage or agency basis.

The Exchange considers that there should be no change in the present policy.

"SPLIT" COMMISSION PRIVILEGES

60. It may be helpful to give here a few notes on By-Law No. 31 (Appendix 34) insofar as it refers to sharing or splitting commissions:

(a) Where a transaction is made by one member for another member, partner, director, etc., and the "transactor" gives up the name of the member, etc., for whom he is acting, the minimum charge that may be made is one-tenth of the regular commission with a minimum of 25 cents (By-Law 31 - 3).

(b) Where the "transactor" also clears the transaction, the minimum charge shall be one-fourth of the regular commission with a minimum of 25 cents (By-Law 31 - 3).

Note: Transactions as in (a) and (b) are known as jitneying.

(c) On transactions by a Toronto member made for a member of the Montreal Stock Exchange, the commission charged shall be not less than one-half the regular

commission (By-Law 31 - 5).

(d) On transactions made by a Toronto member for members of practically every other stock exchange in the world, the commission charged shall be not less than two-thirds of the regular commission (By-Law 31 - 5).

(e) On transactions by a Toronto member for members of the Vancouver, Calgary and Winnipeg Stock Exchanges in certain mining and oil securities listed in T.S.E. Rulings Nos. 12, 14 and 33, respectively, the commission shall be not less than one-half the regular commission (By-Law 31 - 5).

(f) In addition to the above, on all transactions made by a Toronto member for a "non-member" broker, the commission charged shall be not less than two-thirds of the regular commission.

A "non-member" broker is defined as "one who maintains an office and regularly conducts a stock or bond brokerage business with the public, and who has signed the application and agreement form furnished by the Corporation and has been authorized for split commission privileges (as above) by the Board of Governors (By-Law 31 - 6).

CHAPTER III

PERSONNEL - CATEGORIES, QUALIFICATIONS, ETC.

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PERSONNEL

61. While the personnel of member organizations vary greatly according to the nature of the business of member organizations, the three categories of a) sales, b) research and analysis, and c) trading and clerical, are clearly discernable throughout the industry. The most significant trend in recent years has been the greater emphasis placed on research and analysis both as a necessary service for the use of the sales force and an adjunct of underwriting departments.

SALESMEN AND CUSTOMERS' MEN

62. Member organizations and their affiliated companies employ some 1,682 persons in Canada who are engaged primarily in the sales and service portion of the business. There are four categories within the industry; the distinction between them, due to evolutionary changes within the industry, may now be more apparent than real.

(a) Customers' men employed by member organizations are engaged primarily in the solicitation of listed securities business. They are remunerated by salary or a proportion of the commission earned by the firm. They are regarded, and so regard themselves, as providing services to customers by way of information concerning securities and the handling of orders. As their firms may do little or no underwriting, they are not normally engaged in selling new security issues to the public. There are 746 customers' men employed in Canada.

(b) Salesmen are typically employed by member organizations or their affiliates holding membership in the Investment Dealers' Association of Canada. They are engaged primarily in the sale of bonds and debentures and new equity issues, but, to an increased extent, incidental to their duties, may solicit or receive orders in listed securities. There are 869

such bond salesmen employed in Canada by member organizations and affiliates. They are likewise remunerated by salary and/or commissions.

(c) In addition, there are some 356 persons employed by member organizations and affiliates who are registered to deal with the public, but who perform other duties such as those of secretaries, analysts, office managers, etc. The registration and qualification with the Exchange permits them to receive a portion of the commission earned in listed securities business.

(d) There are 67 mutual fund or investment fund salesmen employed in Canada. As the majority of mutual fund and investment fund shares are sold by their own sales organizations, sales by members are not considered to be significant.

QUALIFICATION OF CUSTOMERS' MEN AND SALESMEN

63. The Ontario Securities Act and similar statutes of other provinces provide for the registration of persons trading in securities who may deal with the public. None of the Acts specify any qualifications, however. The Toronto Stock Exchange, in conjunction with some other Canadian stock exchanges, has provided that the employment of such persons must be subject to the approval of the Exchange concerned and that approval may be revoked, whereupon the person's employment must be terminated by the member. It maintains its own register of these employees so that a record is available of their history in the business.

EXAMINATIONS SET BY EXCHANGE

64. The Exchange asks that all new entrants into these categories should have a minimum of three months' experience and have passed a written examination set by the Exchange and designed to test their knowledge of the relevant Securities Acts, By-Laws and Rulings of the Exchange which are applicable to their conduct, and their general knowledge of the securities business. By arrangement with the I.D.A. of C., employees of members are

permitted to take the courses of that Association, and many do so each year.

MEMBERS RESPONSIBLE FOR ACTS OF EMPLOYEES

65. While the training and instruction of applicants of all categories is left to the individual member organization, there is an overriding responsibility to the Exchange in this area, as each member is responsible for the acts or omissions of all employees. Conduct on the part of a customers' man or salesman in the handling of a customer's account which would be considered unethical conduct on the part of the member is so regarded and dealt with, in matters of discipline, as though it were the conduct of the member himself. No customers' man or other employee is permitted to handle discretionary orders or accounts.

66. The educational attainments of sales personnel appear to be higher than in previous periods, as a larger number of persons with university training are attracted to the business. This may be due partly to the greater stability of the industry during the period since World War II. No doubt it is also a reflection of the higher skills and qualifications of the investment managers of members' more important clients such as institutional investors, pension funds, etc.

RESEARCH AND ANALYSIS

67. More than half the member organizations of the Exchange maintain departments of this type of greater or lesser strength. They are regarded as a valuable adjunct to the servicing of and sales to all investors, and particularly institutional investors. This is an expensive type of service provided by member organizations, and one where the quality of the service is highly competitive. Larger organizations engaged in underwriting and distributing new issues, including government and industrial bonds and debentures as well as equity securities, will have Underwriting Departments, which may overlap, to some extent, the functions of the Research Department. The specific knowledge

of companies in Canadian industry possessed by a senior analyst can only be acquired over a period of years, and persons capable of acquiring such skills are much in demand. Recruitment is almost entirely from university-trained persons, and, in recent years, the industry has attracted a number of very competent people in this area. Considerable amounts are also spent by some members on specialized advisory and statistical services.

TRADING AND CLERICAL

68. Trading personnel, both on the trading floor and on the trading desks in members' offices, do not require as extensive an educational background, but are possessed of trading skills by experience and training which qualify them for this particular kind of work.

69. As trading by telephone on a bond desk or a stock desk involves considerable responsibility for dealing in sizeable sums of money, most of the traders in this position have been with the firm for a number of years and are well-known to their counterparts in financial institutions and other members.

70. Floor traders, of which there are 373 at present, are also known as attorneys, as they are authorized by a power of attorney from their member to make binding contracts in the name of the member. Their duties are concerned primarily with the execution of orders on the trading floor. While employees of member organizations or partners or directors of them, they are also subject to the discipline of a Floor Procedure Committee which has the power to fine, suspend or expel the individual trader found guilty of violation of a trading rule or unethical conduct. The trading rules are designed to ensure that customers' orders have priority in the market over orders of all personnel of member organizations and their affiliates.

71. Senior clerical employees now have higher qualifications than they had a few years ago due to the increasing complexity of the business and the use of data processing equipment, although Exchange members are still very large users of unskilled or semi-skilled personnel.

72. The total number of personnel employed by members at the end of 1961 was:

	<u>Male</u>	<u>Female</u>
In Toronto offices	1,807	760
In other offices	<u>1,351</u>	<u>625</u>
	3,158	1,385
	<u>1,385</u>	
Total	<u>4,543</u>	

Note: For firms holding their principal membership in a foreign stock exchange, the above figures include only partners, directors and employees at Canadian branches.

73. Due to the fluctuating volume that is characteristic of the brokerage business, a prime necessity is to reduce fixed overheads as much as possible and to be in a position to expand staff when required. For firms with sufficient basic volume of business, data processing equipment of the punched-card type seems to offer a partial solution. Data processing centres established by equipment manufacturers have attracted a number of more modest-sized firms. These developments have reduced dependence upon unskilled or semi-skilled clerical personnel, and these trends, even more noticeable in the United States, are expected to continue.

CHAPTER IV

CLIENTS AND SHAREHOLDERS - HOW OBTAINED, ETC.

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OBTAINING CLIENTS

74. The investment and/or speculation of money by shareowners is a highly personal matter. It therefore follows that the relationship between members of the Exchange and their clients is a personal one in the nature of a trust, comparable to the relationships that exist between other professional groups and their clientele. Every transaction involves some degree of personal communication between the two parties or their respective representatives. Moreover, this personal aspect, to a large extent, determines the manner in which Exchange members can attract and hold their clients.

ONTARIO GOVERNMENT CONTROL

75. The Securities Act of Ontario (Sec. 53) prescribes conditions under which members of the Exchange (and their employees and agents) may solicit business from the public.

76. The effect of these regulations is to place certain restrictions on Exchange members in soliciting business. The obtaining of clients is usually a subtle matter requiring a high order of social skills in seeking out and developing personal contacts with potential investors. Memberships in clubs, participation in community activities of various kinds, and referrals from existing friends and established clients, are among the many ways in which Exchange members go about building up a clientele.

BOARD ROOMS

77. Many Exchange members maintain "board" rooms (i.e., boards with prices posted thereon) in conjunction with their offices, and this also provides a means of establishing personal contacts with business, executive and office workers in the adjacent area. In more recent years, however, there has been a trend away from board rooms in conjunction with Exchange members' operations, with the result that this has become a less important means of attracting clients.

ADVERTISING BY MEMBERS

78. Most Exchange members advertise their services in local

newspapers and, in a few cases, in national magazines, by radio and television. Radio and television advertising usually takes the form of sponsoring a news broadcast type of programme in which general market information and quotations are given; the broker is not permitted to recommend the purchase of any particular stock, nor to give a forecast of probable market movements. Such advertising must be low-keyed and dignified, as, under the By-Laws of the Toronto Stock Exchange (47 and 51), advertising by members is carefully regulated.

DISTRIBUTION AND CHARACTERISTICS OF
INDIVIDUAL SHAREOWNERS IN CANADA

79. (a) No comprehensive investigation of share ownership by individuals in Canada has ever been made to the knowledge of the Toronto Stock Exchange. Consequently, there is no precise statistical evidence of the extent of share ownership in Canada or of the occupational characteristics and income levels of individual shareowners. As mentioned later on, some indications of these aspects of share ownership may be deduced from taxation statistics, but such indications are necessarily very broad and leave much to be desired from the standpoint of being a definitive analysis.

(b) In 1961, the Toronto Stock Exchange engaged Elliott-Haynes Ltd. to do a public opinion survey in Metropolitan Toronto to measure, among other things, the extent of public participation in the stock market. The following information was disclosed from interviewing 700 adults (men and women) in the upper, the upper middle and the lower middle income groups (the lower income group not surveyed constitutes about 20% of the national total):

(i) In stating a choice of investments thought best
for Canadian families - 48.6% said Government Bonds

21.1%	"	Life Insurance
16.7%	"	Mortgages
6.1%	"	Bank Account
5.9%	"	Real Estate
5.0%	"	Common Stock

(Note: Some gave equal rating to two types of investment.)

(ii) 52.4% had never owned any common stock

30.4% now own stock (34.3% men; 26.5% women)

17.2% do not now own, but have in the past owned, stock

It must be appreciated that the above information is of little use in trying to read the national attitudes.

(iii) It would be useful to have reasonably accurate nation-wide statistics on share ownership and on the factors which influence investors in their choice of securities.

It is suggested that this project might be undertaken by the Dominion Bureau of Statistics, say on a quinquennial basis.

DISTRIBUTION AND CHARACTERISTICS OF
INDIVIDUAL SHAREOWNERS IN U.S.A.

80. By comparison, a number of surveys of share ownership in the United States have been made, which have shed considerable light on that subject in that country. In view of many similarities between Canada and the United States in terms of economic development, political philosophy, financial institutions and standards of living, it would not be unreasonable to suggest that the incidence and pattern of individual share ownership in Canada broadly parallels that of the United States. For that reason, the following information is included in this brief.

81. In 1951-1952, the Brookings Institute, in co-operation with the New York Stock Exchange, made the first comprehensive investigation into the ownership of business and industry in the United

States. This survey was followed up in 1956, and again in 1959 and 1961, by a census of shareowners made by the New York Stock Exchange. A comparison of the results of these investigations affords informative insight into the kind of share ownership in that country (see Appendix 16).

TYPICAL SHAREHOLDER

82. From the data in Appendix 16, a picture of a typical shareowner in the United States may be drawn. The person is likely to be about 50 years of age, to have an annual income in the \$5,000 to \$10,000 bracket, to have had some college training, and to be either a housewife in the case of women shareowners or engaged in a managerial or professional capacity in the case of men shareowners. In addition to their shareholdings, he or she is likely to have life insurance, a savings account, U.S. Government bonds, and to own their own home. In view of the similarities between Canada and the United States as pointed out above, it would be not unreasonable to suggest that the picture of a typical Canadian shareowner would bear a resemblance to his United States counterpart.

SHAREHOLDERS BY INCOME GROUP

83. According to the "1961 Taxation Statistics of the Department of National Revenue, Canada" which reports on 1959 tax returns, indications are that a larger percentage of individual taxpayers in the higher income brackets are shareowners compared with those in the lower income groups. This seems only logical to expect, because taxpayers in the higher income groups have a higher propensity and opportunity to save than taxpayers in the lower income bracket. For the same reason, dividend income of individual taxpayers in the higher income groups forms a larger proportion of their total income compared with those in the lower income groups. In 1959, dividend income for all individual taxpayers averaged 1.7% of total income, while the amount of dividend income averaged \$70 per individual taxpayer.

BY OCCUPATION

84. Based on the same taxation statistics, shareowners are to

be found among all occupational groups, but certain tax-paying occupational groups would appear to contain a higher percentage of shareowners than others. Occupational groups with higher-than-average dividend income, both in terms of absolute amount and as a percentage of their total income, are accountants, medical doctors and surgeons, dentists, lawyers and notaries, consulting engineers and architects, proprietors of financial businesses, investors and tax-paying pensioners. It would seem to be significant that such occupational groups are also groups requiring higher levels of education to qualify for their occupations. (For detail of taxation statistics, see Appendix 17).

INSTITUTIONS AS SHAREHOLDERS

85. We have been speaking of individuals as clients, but another and very important type of client is the Institution, i.e., mutual funds, insurance and trust companies, banks and pension funds. For the extent of holdings by institutions, see Appendix 14. Mutual funds of the open-end type are the largest single type of institutional client in the market today.

HOW STOCK BUSINESS ALLOCATED

86. Large institutional accounts do not normally confine their business to a single member of the stock exchange. The manager of the investment department of a large institution is in constant contact with several salesmen and stock traders at a variety of firms. Before making a large purchase or sale, he will obtain bids or offerings from several sources. The large institutions usually maintain their own stock research and statistical departments.

FINANCING CLIENTS' ACCOUNTS

87. The Toronto Stock Exchange, in common with other exchanges in Canada, permits the purchase of stock on a margin of 50% of the purchase price provided it is over \$1.00 per share, and this percentage must be maintained at all times. The relevant Toronto Stock Exchange regulation and margin agreement is at Appendix 15.

It should be noted that this is a self-imposed regulation and is rigidly enforced. The Exchange staff of Examiners are constantly doing "spot checks" in addition to normal audits, to ensure that members are keeping clients' accounts properly margined. It is interesting to note that some twenty members of the Toronto Stock Exchange carry no margin accounts.

88. United States Practice: The United States Federal Reserve Board determines from time to time the percentage of initial margin required, and, at present, it is 50% of purchase price. The stock exchanges set the minimum margin requirements to be maintained, and, at present, the New York and American Exchanges require 20%. Hence, our requirement of 50% to be maintained is more stringent than in New York.

89. Canadian Experience: There has been nothing in recent years to indicate that regulations beyond those now imposed and exercised by the Exchange itself are necessary. The terms of credit are, of course, already affected, if not actually controlled, by the Bank of Canada's influence on interest rates.

INSTALMENT BUYING

90. The Toronto Stock Exchange, by various methods described elsewhere in this brief, encourages Canadians to buy equities, but only if they are able to pay for them.

91. United States System: The New York Stock Exchange has been sponsoring a monthly stock purchase plan, but, in their system, when a client makes a payment, his broker actually buys shares or fractions of shares and, thus, the stock is bought at the price then prevailing and it is fully paid. The investor buys stock by "dollars worth" rather than by the share - there is no credit involved and there is no penalty and no loss if the investor fails to make a monthly payment. Because of the size and density of population, there is apparently a sufficiently large number of "small" buyers to make it a practicable plan. This would not be so in Canada, although it may be at a later date. The New York plan is feasible because there are two "odd-lot" brokers who do

the major portion of the bookkeeping and accounting, thus minimizing the cost of handling these small accounts.

92. The Toronto Stock Exchange considers it is potentially dangerous to encourage investors - particularly new and small investors - to buy stock on a time payment plan for several reasons:

- (a) It is not considered sound investment practice to buy stock at today's prices and pay for it over several months in the future. The dollar averaging system is recognized as the sound system of investment, i.e., buying at the price prevailing at the time cash payment is made.
- (b) The investor must pay high interest rates on the unpaid balance whilst his stock is usually earning much lower interest rates.
- (c) If the investor is unable to keep up his payments, he must be sold out - probably sustaining loss and, thus, this leading to recrimination against the broker and a bad impression of equity investment.
- (d) It is economically impossible in Canada at present for a broker to adequately service such an investment plan and the clients concerned.

IMPACT OF INSTALMENT PURCHASE PROGRAMMES

93. The impact of the monthly investment plans which have been initiated by various stock exchanges would appear to be very slight. Even the New York plan, which is probably the most successful, has had little effect on the investment community. Total purchases under the New York plan during the past eight years were only \$233 million, compared with the total trading value of about \$52,700 million during 1961 only.

"FREE RIDING"

94. In the investment industry, the term "free riding" refers to the practice of buying stock on an "if, as and when" issued basis. The practice is usually carried on in new stock issues in the period before payment is required and where a price rise is expected.

Clients who have bought stock on an "if, as and when" issued basis are not required to pay for the stock until the actual certificate has been received, and this usually varies from two to five weeks. Although the practice of "free riding" is detrimental to legitimate investors, it would be very difficult to eliminate by regulation and it should probably be left as it is now, i.e., to the individual member involved to attempt to eliminate the practice by not selling new issues to known "free riders" - and they do become quickly known.

95. "Free riding" interferes with the marketing of new issues because it results in the "freely ridden" stock being sold immediately after the issue, thus disturbing the market. In order to maintain or restore stability in the market for the new stock, the issuing dealer must then buy back a portion of the stock he has sold. The percentage of the total issue which is sold back to the dealer by "free riders" can vary widely.

96. Preferred Treatment: The extent to which established retail and institutional buyers receive preferred treatment at the time of a new issue differs greatly. As in all businesses, long-established active retail and institutional accounts usually do receive preferred treatment with regard to size of allotment, etc., during new issues. Of course, this practice will not be carried to the extent that prevents the firm from attracting new clients.

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PART I

TYPES AND FACTORS AFFECTING PRICE

TYPES OR CLASSES

97. Shares are divided into two principal classes, Preferred and Common.

98. The Preferred Stock carries a voting privilege only under certain circumstances; normally, it has a cumulative, fixed rate of dividend with a "preference" or prior claim over dividends on the Common; it also has a prior claim over Common - but a claim junior to bonds or debentures - in case of liquidation of the company's assets; its dividend payments are the subject of decision by the directors, whereas interest payment on a debt security (bond) is a fixed charge on company assets or earnings. Preferred dividends, however (as well as Common), are eligible for the 20% dividend tax credit allowed to Canadian individual shareholders; bond interest is not so eligible.

99. There are various types of Preferred - cumulative, i.e., dividends in default are carried forward; non-cumulative; participating, i.e., having a share in profits after Common dividend is paid; non-participating; callable, i.e., may be redeemed at certain prices; and non-callable.

100. Some factors affecting the price of Preferred are the security of the dividend (company earnings); the level of prevailing interest rates; the presence of a sinking fund; and the call price. Usually, the price on high quality Preferred will fluctuate with the level of interest rates; the price of low quality Preferred will vary with the state of the company's affairs.

101. The Common Stock usually does carry a voting privilege*; its dividend is fixed from time to time by the directors, and this is usually related to the earnings. Investors buy Common for two reasons - dividend income and capital appreciation. The price of

* although a company may have various "classes of Common Stock, "A", "B", etc; one class may have a voting privilege and another class not; one class may be entitled to a limited dividend or may have its dividend deferred until certain stipulations have been met.

the shares will vary in accordance with the opinion of the investors as to the potential of the company. This potential is affected by many factors - some of which are quite unpredictable - e.g., the decline of international oil stocks in 1956, newsprint stocks in 1958 and uranium in 1959. These declines all resulted from reduced earning potential through unforeseen circumstances.

FACTORS AFFECTING
SHARE PRICES

102. (a) The industry of which the company is a part. If the industry is likely to prosper, the company should get a share of it. E.g., Is the industry serving a growing or declining market? Is the industry likely to meet more or less competition, domestic or foreign? Are government policies or regulations apt to restrict or free the industry? Etc.

(b) Earnings record. The past earnings of a company must be studied with the object of finding the trend of profits. After making allowance for changing circumstances, attempts are made to project past trends into the future.

(c) Management. Management of a company is one of the most important factors to be considered when assessing a stock. The past record of a company is usually a good indication of the ability of management. By diversification and many other methods, good management can often rapidly build up the earnings of the company which has a poor record of declining sales and profits. Conversely, poor management can be highly detrimental to a growing profitable firm.

(d) Analysis of Financial Statements. An analysis of a company's financial position and the trend in working capital and cash flow is important. Capitalization and the possible effect it might have on the earnings available for the common stock under various circumstances must be considered, and also various statistical financial

relations such as profit margins, return on invested capital and the exact composition of the company's capitalization, i.e., debt, preferred stock and common stock.

(e) Psychology. Psychology also plays an important part in the level and trend of stock prices. This is evidenced by periodic erratic fluctuations in stock prices caused by the temporary placing of too much emphasis on a single determining factor, which, when removed, momentarily disturbs the market. Recent examples of this were the over-emphasized atmosphere of risk and uncertainty surrounding common stocks in 1949 when yields in excess of 10% were available on relatively good quality stocks. This attitude entirely reversed itself in the following five years, and we may now be emerging from a period when too great an emphasis was placed on the possible long-term growth in earnings and too little weight to the uncertainties involved in predicting potential, i.e., projecting past growth trends into the future.

"YIELDS" AND "PRICE:EARNINGS RATIO"

103. There are two major indicators used by investors in appraising the present and future earnings power and dividend-paying ability of a specific stock. These are a) yield, b) price:earnings ratio.

104. Yields on investment grade common stocks vary in a wide range. In general, if a stock rises to the point where the yield is negligible, it is an indication that investors believe that the earnings of the company will grow to an extent that will permit an increase in the dividend to an amount where the yield will rise to justify the high price of the stock. Conversely, if the yield on a stock is extraordinarily high, it is an indication that investors believe the earnings of the company will decline and necessitate a reduced dividend, thus reducing the yield on the stock to a normal

relative level. Many stocks in Canada are now selling at 20 times earnings to yield less than 3%; the investor is hoping earnings and dividends will increase and thus reduce the price:earnings ratio and increase the yield.

PART II

THE DEMAND FOR EQUITIES

INFLUENCE OF INSTITUTIONS GENERALLY

105. The growth in demand for equities over the past decade and the increase in holdings of stocks by financial institutions in Canada are subjects of great interest and importance, but for which only limited statistical information is available. The growing institutionalization of personal savings has mainly resulted from a) the introduction of pension funds into most business organizations, b) a strong public demand for mutual funds shares, and c) life insurance; all generated by the steady increase in personal incomes which has taken place since the Second World War. These consumer savings flow into the various institutions and are invested by experienced portfolio managers. The skill of these experts in arranging the investment of such massive amounts of funds has contributed greatly to the orderly functioning of the market. For this reason, the institutionalization of personal savings is in many ways to be welcomed and encouraged. The increasing scale of equity purchases by these institutions (see Appendix 7) has no doubt been caused to some extent by the high rate of economic growth and attendant inflationary forces experienced in Canada in the post-war period.

PENSION FUNDS

106. There has been a very substantial growth in pension plan underwriting since the end of the Second World War, especially in trustee and insurance company plans, and funds from these sources contribute importantly to the demand for equities. Certain changes in the laws governing the investment of these funds have also been an important factor. The Amendment to the Act passed in 1956 governing pension funds in Canada now frees trustee pension plans from a previous requirement which limited their investments to those legal for insurance companies; furthermore, the ceiling of 15% on the proportion of equities held was removed at that time. In 1960, the law governing insurance company

annuity underwritings was altered, with the same limitations being removed. Many pension funds have adopted a policy of dollar averaging, and this type of programme has the effect of creating a steady demand for equities and giving a certain amount of stability to price levels.

107. According to the Dominion Bureau of Statistics, trustee pension plans of incorporated companies in 1952 held \$52 million in Canadian preferred and common stocks, or 7.2% of the total portfolio. By 1960, this figure had risen to \$239 million, or 11.1%. These figures account for only the trustee pension plans of incorporated companies, which, however, are by far the most important single factor within the pension group.

108. Appendix 7 illustrates the very rapid growth in pension plans in Canada during the post-war period.

MUTUAL FUNDS

109. Mutual Funds have become the greatest source of demand for equities amongst all institutional buyers in the post-war period. Figures as to the growth of these funds are shown in Appendix 8.

110. The "open-end" funds have been the major contributors to the growth of this group, with the "closed-end" funds participating only to the extent of switching between equities and bonds or raising new capital as a result of new financing, both of which to date have been relatively unimportant during the period reviewed.

111. Much has been said about the growing power of the mutual funds and pension funds, and the danger of the large equity holdings of these groups from the standpoint of being a potential threat to the stability of the stock market through injudicious and untimely buying and selling of large amounts of stocks. However, experience shows that these organizations are well qualified as investment managers and, while their stock purchases and sales have an important bearing on market activities, they are supervised by experienced fund managers and are not the disturbing factor many observers believe them to be. The majority of their sizeable purchases and sales are dealt with in an orderly manner, and, in

the recent record market decline in the New York market in May 1962, institutional investors were given high praise for their market performance. It is well known that large and small mutual funds were heavy buyers and that institutions generally played a major role in arresting the market decline. We believe that a similar pattern was followed by the funds in Canada.

N.R.O. FUNDS

112. Another important demand for Canadian equities developed in 1954 through the establishment of Canadian incorporated non-resident owned mutual funds (familiarily known as N.R.O. Funds), whose shares were primarily offered to residents in the United States. These funds were designed for U.S. investors in view of certain tax advantages which accrued to them under United States tax laws. Up to the present, U.S. holders of shares of these N.R.O. funds have received special tax treatment under U.S. laws in view of the fact that the income and capital gains are not distributed to shareholders, with the result that shareholders only become liable for U.S. taxes when they redeem or sell their shares. It is now proposed in the United States that tax laws be changed so that shareholders of N.R.O. funds be taxed on the same basis as shareholders in U.S. incorporated mutual funds. For this reason, these funds have lost much of their popularity and, through net redemptions, some liquidation of their portfolio investments has taken place. Furthermore, if this new tax basis becomes effective, the advantages of N.R.O. funds to U.S. investors would be greatly reduced and share redemptions could present a major problem to the Canadian market as a result of forced liquidation of large holdings of Canadian equities. However, it is understood that many N.R.O. funds have been building large cash reserves through the sale of equities over the past several months in the event that the above-mentioned change in tax laws will be made. This should be effective in reducing any future selling pressure on the market from this source.

LIFE INSURANCE COMPANIES

113. The proportion of assets invested in common stocks by the life insurance companies is very small indeed and well below the

15% statutory limit established in 1932 under the Canadian and British Insurance Companies Act. Appendix 9 shows the percentage distribution of various categories of life insurance companies' assets. It will be noted that the total holdings of Canadian preferred and common shares for the year ended 1961 was 1.5% of investment portfolio. This proportion has remained constant for a technical reason due to the "valuation risk" rather than due to the true opinion of common stocks as long-term investments. If insurance legislation respecting the year-end valuation of equities on the basis of market value were changed and the insurance companies were given greater latitude in the selection of their investments, it might encourage the placing of a higher proportion of their assets in the form of equities.

RELUCTANCE OF CANADIAN INSTITUTIONS
TO BUY EQUITIES

114. It is also true, of course, that, on the other side of the picture, many buyers of securities, particularly institutional buyers, have been reluctant to place their funds in common stocks. Legislation in Canada pertaining to the employment of funds by investment companies, trust companies, etc., has greatly restricted equity investment, and, in addition to this, the traditionally conservative attitude of Canadian investors has had the effect of limiting participation in new or unseasoned issues.

115. A recent example of the extent to which equity participation has developed in the United States may be instanced in the case of the Endowment Fund of Harvard University, which, last year, had a value of some \$750 million. Of this amount, 40% was invested in common stocks. In some other instances, endowment funds are almost fully invested in common stocks, but, in any case, the average is very much higher than is the rule in Canada.

116. In this country, our banking system is such that the banks operate mainly in the short term and to a very limited extent in the long term money markets. They do not, as a rule, take an active participation in equity investments. The rapid and extensive development of the United States in the 19th and early 20th Centuries was no doubt assisted by the flexibility and wider investment interest of their banking institutions.

TRUST COMPANIES

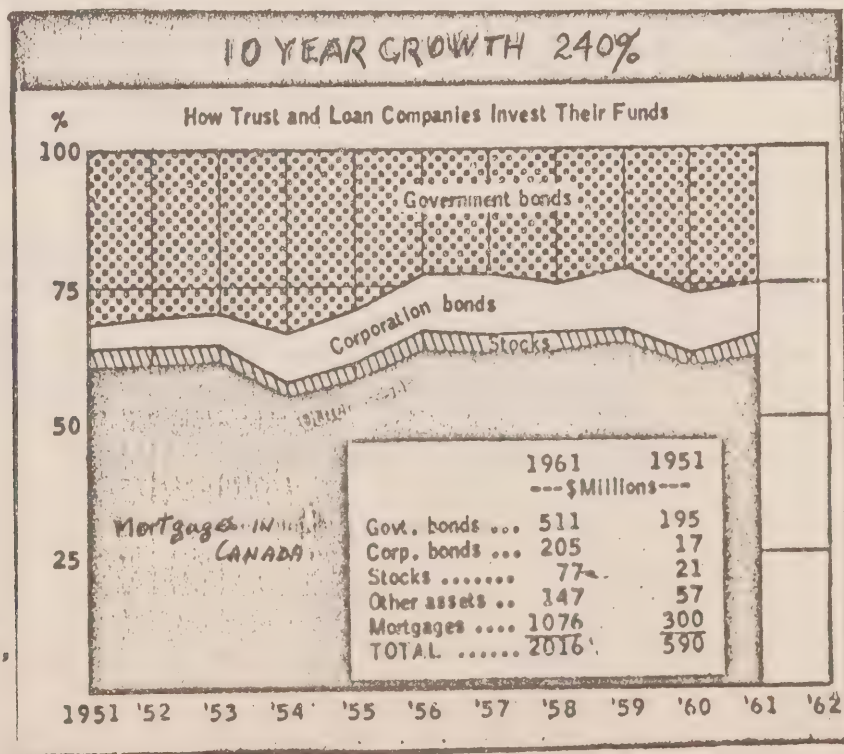
117. Trust companies have become a very important factor in the demand for equities, but, unfortunately, complete statistics in this sector are not available. Administered funds consisting of estates, trust and agency funds make up the greatest proportion of total assets under administration, as may be seen from the following table:

Total Assets Under Administration
By Members of Trust Companies Association of Canada

	1961	1960	Change
	\$	\$	%
Company funds	185,630,930		+ 16.5
Ordinary deposits	612,144,007		+ 32.3
Guaranteed invest. certificates	797,711,248		+ 17.5
Interest due and accrued	9,125,312		+ 80.7
Estates, trusts and agency funds	8,142,835,374	7,390,429,637	+ 10.2
Total	9,747,446,871	8,696,218,888	+ 12.1
Operating Results			
Income	80,681,065	70,474,543	+ 14.5
Expenditure	59,229,283	52,974,379	+ 11.8
Gross profit before inc. taxes	21,451,782	17,500,164	+ 22.6
Net profit after inc. taxes	11,874,105	10,041,778	+ 18.2

Source: The Financial Post, June 2, 1962.

118. Of the total assets under administration, estates, trusts and agency funds represent \$8,142,835,374 and, although no break-down of this figure is available, undoubtedly a large proportion of this amount is invested in equities. The proportion of the remainder of trust company assets which are invested in equities is very modest and has shown very little trend in recent years. From the figures shown in the chart below, it will be seen that the demand from this latter source is of relatively little importance.



Source: The Financial Post,
June 2, 1962

119. There is a paucity of statistical information available as to the investment of funds administered by Trust Companies, and it might be helpful if more information could be made available concerning such investments.

NON-RESIDENTS

120. Since the end of the Second World War, a very substantial flow of foreign funds has been placed in equities in Canada, both in direct and portfolio investment. Direct foreign investment in Canada has largely been in our natural resource and manufacturing industries. Without this large foreign participation, it is doubtful if the expansion in our economy could have taken place to the extent that it has. Portfolio investment in the post-war years has also been substantial, especially by U.S. investors. Investors in the United Kingdom and on the Continent also made substantial purchases of Canadian stocks, but, in recent years, the demand has dropped considerably and is currently resulting in a net outflow of funds. This may be attributed to several factors such as the floating rate on the Canadian dollar which existed until recently, withholding taxes imposed on non-resident holders of Canadian securities and the fear of Government expropriations of certain public utilities. Figures for 1962 on the ebb and flow of security transactions with non-residents are not available, but it would seem evident that the demand for equities by non-residents from all sources is now running at a net debit and has resulted in a large withdrawal of funds from Canada.

121. The following table shows that, up to the end of 1961, there was on balance an inflow of funds from international transactions in Canadian stocks, but we believe that, in 1962 to date, this trend has been reversed:

<u>Security Transactions Between Canada and Other Countries</u>								
Net Sales (+) or Purchases (-)	1954	1955	1956	1957	1958	1959	1960	1961
<u>Canadian Securities</u> (Millions of dollars)								
Trades in outstanding stocks	+129	+138	+188	+137	+ 88	+110	+ 49	+ 40

<u>Net Sales of Outstanding Canadian Stocks to Non-Residents</u>				
(Millions of dollars)				
Quarter	Total	United States		Other Countries
1960 I Q	13	5		8
II Q	24	22		2
III Q	10	14		- 4
IV Q	2	13		- 11
1961 I Q	13	21		- 8
II Q	32	45		- 13
III Q	-	22		- 22
IV Q	- 5	32		- 37

121b. Since the above was written, the D.B.S. has issued figures indicating that, in the first five months of 1962, there was a net capital outflow of \$88 million from trades in all outstanding securities, compared with a capital inflow of almost the same size in the same period last year. In May alone, foreigners sold to Canadians a net of \$15,300,000 in Canadian stocks - the largest monthly re-purchase balance since the Second World War.

CONCLUSIONS

122. Statistics are not available which provide a break-down of the proportion of stock business accounted for by each of the main classes of financial institutions such as pension funds, mutual funds and trust and life insurance companies. However, in a 1962 publication, the New York Stock Exchange FACT BOOK, institutions and intermediaries for the first time in eleven studies accounted for approximately 25% of the share volume on the New York Stock Exchange in September 1961, while slightly more than 50% was accounted for by transactions of public individuals.

123. While no comparable statistics are available for the Toronto Stock Exchange, we believe that much the same pattern applies and, of total share volume, the individual investor still accounts for the greatest proportion.

124. The Stock Exchange sees no reason to recommend a change at the present time in the investment activities of Pension and Mutual Funds; however, the Exchange is concerned about the lack of adequate supervision, control and training of salesmen for Mutual Funds. It is hoped that the Funds or their Association will take early steps to correct this weakness and so raise the standard of their selling organizations.

124a. The Toronto Stock Exchange believes that it is desirable for Canadian stock ownership to be broadened, and that a downward revision of the present tax structure is necessary to strengthen the economy and encourage new investment in Canada. The importance of foreign capital in contributing to Canada's post-war development cannot be overlooked, and, if the country's development is to continue at an appropriate rate, foreign capital in large amounts will continue to be a necessary requirement. To

assure that it will be available, confidence in the future of Canada and its monetary and fiscal policies must be restored and maintained.

NON-FINANCIAL CORPORATIONS

125. Unfortunately, statistics to indicate the extent of the demand for stocks by non-financial corporations are non-existent.

As a result, any observations of activity in this area can only be based on the general experience of Exchange members, which indicates that, with certain exceptions, these corporations are not stock buyers.

126. Among the exceptions are certain industrial companies which, for a number of reasons, have become partly "investment trusts" in character. However, such companies are not under pressure to invest a regular flow of funds, nor are they exposed to redemption of their share capital and accompanying involuntary liquidation of portfolio investments, as is the case with mutual funds.

127. Other exceptions are found among a number of mining and oil companies whose reserves have become partly or wholly depleted. To offset the effect of this depletion, excess funds are invested in the shares of other companies, usually of those engaged in the same field. Share acquisitions of this kind are sometimes made on the basis of holding for the long term, but, in other cases, these companies do a considerable amount of trading, although not enough to have a real effect on the demand side of the market.

128. Companies which invest in shares of other companies engaged in a line of activity that has some direct bearing or influence on their own field of business are also exceptions to the rule. Examples of share investments in this category are the investments which a number of major oil companies have in the share capital of crude oil pipelines. In addition to being associated with each other through share holdings, it will often be found that other contractual relations exist, such as through-put agreements in the case of the above example. A company may also invest in the shares of another company which is an important supplier or an important customer. This is done to protect the source of supply of raw materials or the outlet for finished products. Share investments made by companies for the foregoing reasons tend to be of a long term nature and therefore contribute little to stock market activity.

129. Another example of share investing by non-financial corpora-

tions is the case of some family-owned or controlled corporations. Being operated primarily to suit the requirements of major shareholders, they tend to follow a policy of building up equity interest by investing earnings in shares of other companies rather than paying out liberal dividends which would be taxable in the hands of the individual shareholders. In effect, such companies operate partly as individual investment trusts, with investment policy being geared more to the investment objectives of the major shareholders rather than to the needs of the corporation. In the fixed income section of the portfolio, emphasis would be placed on owning preferred shares rather than bonds and debentures, since dividend income is not taxable income in the hands of the corporation, whereas interest income would be. It is thought that there are relatively few companies in this category in Canada, so that their impact on stock market activity is likely to be relatively small.

INVESTMENT ACCOUNTS OF PROVINCIAL
AND MUNICIPAL GOVERNMENTS

130. With one exception, provincial governments are precluded by statutory requirements from investing the funds of their various controlled accounts in preferred and common stocks. Each province has its own governing Act in this regard, such as "The Financial Administration Act" of the Province of Ontario and "The Department of Finance Act" of the Province of Quebec. The one exception is the Province of Nova Scotia, which recently passed "The Provincial Act of 1962 Bill Number 5"; under this Act, provision is made to allow such government accounts in that province as Pension Fund, Workmen's Compensation and Teachers' Superannuation to purchase either preferred or common stocks up to 20% of the total portfolio provided that not more than 40% of the total is invested in corporation securities of all types. In view of the fact that this Act has just come into being, it is too soon to assess the effect it might have on the investment policies of the government accounts affected.

131. Municipal governments are restricted by provincial legis-

lation to investing their funds in so-called "trustee investments", which generally means federal, provincial and municipal government securities. In Ontario, the governing Act is the "Municipal Act" with Section 12 (2) applying to Revenue Funds and Section 325 applying to Sinking Funds. These various provincial Acts and the regulations thereunder have been in force for a good many years and, as far as is known to the Toronto Stock Exchange, no changes are presently contemplated to permit municipalities to invest their funds in preferred and common shares.

132. In view of the foregoing limitations, investment action by provincial and municipal government accounts have no influence on the stock market.

INFLUENCE OF TAXATION ON DEMAND

133. The incidence of taxation in Canada on corporate and individual taxpayers has an important bearing on the investment decisions of individual investors. At the present time, income earned by a limited company is subject to the following taxes, all of which are payable by the corporation:

- (1) A federal income tax of -
 - (a) 18% of the taxable income, if the amount of such income does not exceed \$35,000, and
 - (b) 47% of the amount of taxable income in excess of \$35,000.
- (2) A federal old age security tax of 3% of the taxable income.
- (3) A provincial income tax is presently imposed by the Provinces of Quebec and Ontario upon the profits of companies doing business therein. The rate of tax imposed by Quebec is 12%, while Ontario imposed a tax of 11%.

A credit of 9% may be now deducted from the federal tax in respect of these provincial income taxes in 1962 and subsequent years.

DOUBLE TAXATION

134. It has been one of the fundamental principles of Canadian taxation policy for many years to subject profits earned by limited companies to double taxation. The profits are first taxed at the above rates in the year in which they are earned by the company. The balance of such profits is then subject with certain exceptions to second taxation in the hands of shareholders when distributed to them as dividends, or in other forms which are held to be the equivalent of dividends for purposes of the Income Tax Act. Dividend income in the hands of individuals are taxed on the basis of a graduated scale of rates according to their level of taxable income. In general, dividend income received by a Canadian company from other corporations is not subject to corporate income taxes in the hands of the receiving company.

EXCEPTIONS OR MODIFICATIONS

135. Several exceptions and modifications of this general rule of double taxation have developed over the years, such as the fact that special rates of taxation are imposed upon certain types of companies such as investment companies, non-resident owned investment corporations, foreign business corporations, personal corporations and others. Provision is made in the Income Tax Act for companies to pay a special 15% tax upon earned surplus accumulated to a certain date and so enable their shareholders to be free of tax when this surplus is ultimately distributed in certain ways. It is also possible to reduce the tax payable to not more than 20% of the earned surplus through the use of a "trader company" or a tax-exempt organization as an intermediary.

136. Apart from these exceptions and modifications, however, the general rule of double taxation of corporation earnings still applies to the vast majority of corporations and their shareholders. The result of this double taxation is to impose a heavy burden of taxation upon the income earned by limited companies and their shareowners.

DIVIDEND TAX CREDIT

137. To relieve this burden of taxation to some extent as far as

shareowners are concerned, special provisions exist which provide that individual Canadian taxpayers who receive dividends from Canadian companies which are taxable in Canada are permitted to deduct, from the taxes payable by them on such dividends, 20% of the Canadian dividends received. This 20% dividend tax credit arrangement is unique to Canada and, together with the fact that stock market profits made by Canadian shareholders are not subject to a capital gains tax as is the case in certain other countries, has contributed to a greater demand for preferred and common shares in Canada relative to other forms of investment than might otherwise be the case.

138. From the standpoint of the individual investor, the 20% dividend tax credit has meant that investment in preferred and common shares is often much more attractive than interest-bearing securities, depending upon the taxable income bracket of the individual. This is indicated by the following tabulation, which shows the yield which must be earned by an interest-bearing investment in order to equal in the hands of the recipient, after taxes, a net tax paid yield of 4.50% and 5.00%, respectively, from shares in taxable Canadian corporations:

<u>Taxable Income Bracket</u>	<u>1961 Tax Rate</u>	<u>Yield on interest-bearing securities required to equal net tax paid yield from shares of 4.50% and 5% respectively</u>	
		<u>4.50%</u>	<u>5.00%</u>
\$ 5,000 - \$ 6,000	22%	5.65%	6.28%
6,000 - 8,000	26	5.71	6.35
8,000 - 10,000	30	5.78	6.42
10,000 - 12,000	35	5.88	6.53
12,000 - 15,000	40	6.00	6.66
15,000 - 25,000	45	6.13	6.81
25,000 - 40,000	50	6.30	7.00
40,000 - 60,000	55	6.50	7.22
60,000 - 90,000	60	6.75	7.50
90,000 - 125,000	65	7.07	7.85
125,000 - 225,000	70	7.50	8.33
225,000 - 400,000	75	8.10	9.00
Over \$400,000	80	9.00	10.00

Note: The foregoing calculations are based on the premise that income from the intended investment will be additional income attracting income tax at the rate applicable to the investor's highest taxable income bracket.

INSTITUTIONAL INVESTORS NOT BENEFITED

139. While the 20% dividend tax credit has benefited the individual taxpayers, it has not provided any advantages to institutional and other investors who are not subject to taxation on investment income. Such investors, for example, find preferred shares less attractive than bonds for the fixed income portion of their portfolio in view of the effect which the 20% dividend tax credit has had in lowering the yields obtainable from this type of investment.

INFLUENCE OF TAXATION ON RISK FINANCING

140. The influences of taxation on investment decisions are myriad and affect both the demand and supply side of the market. The first and most obvious influence is that taxation of any kind serves to divert funds from the private channels of the economy to support of government activities. The progressive structure of the tax rates, especially in personal tax rates and estates tax rates by which those with the highest incomes and largest estates pay taxes at the highest rates, has been an important factor in sharply restricting the ability of individuals or small groups of individuals to amass funds with which to finance major business ventures. Taxation, both of individuals and corporation, is often said to impair incentives to undertake desirable and necessary, albeit risky and arduous, programmes.

141. The technical provisions of the taxation legislation have important effects. The fact that bond interest payments are deductible by corporations as expenses in computing income for tax purposes, while dividend payments are not, has obviously been a very important consideration in those many cases in which corporations have chosen to raise new capital through bond issues rather than stock issues. The 20% tax credit on dividends has worked in the opposite direction. The absence of a tax on capital gains, coupled with the progressive nature of personal income tax rates,

has led investors, particularly those in high income tax brackets, to seek out situations in the stock market that offer prospects of capital gain in preference to regular income.

142. The Toronto Stock Exchange believes that the entire taxation structure in Canada should be the subject of government review in which every consideration is given to reducing the burden of taxation now imposed on corporate or individual taxpayers OR to designing a new formula for taxation which would tend to encourage corporate financing through stock issues rather than by bond issues.

PART III

THE SUPPLY OF EQUITIES

AVAILABLE ON THE T.S.E.

143. A broader cross-section of equities made available to investors would be of advantage to Canada. The Toronto Stock Exchange now provides facilities for trading a large number of equities representing a substantial value. At the end of 1961, there were 1,117 stocks listed, with a market value of \$61,073,003,583. It is appreciated that the market values represent some shares which are closely held and not likely to be available for trading, but, during the year 1961, 719,320,976 shares traded with a total value of some \$2,526,349,869 (Appendix 10). During the first six months of 1962, 408,540,613 shares traded with a total value of \$1,185,778,009.

MORE VARIETY REQUIRED

144. During recent years, there has been a reasonably steady increment of equities through new issues (see Appendices 11 and 12). These have covered a fairly wide field of enterprise, but a broader cross-section of Canadian securities would not only enable Canadians to participate more widely in business in Canada, but would also invite capital portfolio investments from other parts of the world. To this end, the Exchange is constantly encouraging additional qualified listings. It is appreciated that the geography of Canada and our relatively small population preclude complete representation in such industries as aircraft, chemicals, electronics, railways, etc., but there are other fields which could have more complete representation. In truck and motor car production, for instance, only one Canadian producer has its shares listed and, of its outstanding capital stock, some 75% is owned by the American parent. There are about five other American-owned producers whose vehicles are manufactured or assembled by Canadian subsidiaries, none of whose Canadian equities are available for purchase. Similar situations apply with respect to many major industrial classifications.

PARTICIPATION IN FOREIGN-OWNED
SUBSIDIARIES OPERATING IN CANADA

145. There has been considerable public discussion in Canada concerning the inability of Canadians to buy equities in Canadian subsidiaries of foreign-owned corporations. In the post-war boom, the Canadian economy was expanding at a greatly accelerated rate to satisfy the pent-up world demand for Canadian goods. The expansion which took place would not have been accomplished without the help of tremendous amounts of foreign capital, and, during this expansion period, Canadians welcomed this help in whatever form it chose to take (Appendix 13 indicates the amount and type of foreign investment as at 31 Dec. 1959).

146. Today, with this period of accelerated expansion behind us, we should not fail to remember that foreign capital, particularly American capital, was very helpful during this time and may be so again in the future. We are of the opinion that an increase in the supply of equities of Canadian subsidiaries of foreign-owned corporations should be encouraged in ways which will be beneficial both to the corporations concerned and to the Canadian investors. Care must be taken to ensure that any encouragement or inducement to increase supply of equities from this source by legislative action is not interpreted as punitive and thus results in impeding the flow of capital into Canada. From the standpoint of the Toronto Stock Exchange, there would be, of course, a distinct advantage in having Canadian participation in foreign-owned Canadian corporations, since members of the Exchange would have a wider range of shares in which to trade. However, the Exchange believes that the apparent immediate benefit would be outweighed by other considerations if this were in any way forced upon the corporations concerned.

147. From the point of view of the foreign-owned corporation, there appear to be two principal advantages to Canadian participation in the equities of its Canadian operation. The first is in the field of public relations. It would be good business to have a partial Canadian ownership of companies doing business in Canada.

This would strengthen our ties with the foreign corporations which see fit to spend many millions of dollars in Canada in plant and equipment, and in producing employment for Canadians. The second advantage, particularly in the field of consumer goods, would be that the owner of shares in a company is favourably inclined to purchase the goods of such company and, the more Canadian shareholders there are in this type of company, the more potential customers there are for the company's goods. These advantages are not always present, but, when they are not, other advantages must be available to encourage financing in Canada.

INFLATION DISCOURAGES EQUITY FINANCING

149. One point that has mitigated equity financing since the Second World War has been inflation. It has been attractive to borrow funds for a stated period with some certainty that the repayment date would find the currency with a reduced purchasing power.

STUDY OF INCENTIVES NEEDED

150. The Toronto Stock Exchange believes that it is important to maintain the flow of funds for capital investment and that this can best be accomplished through incentives, but the Exchange also believes that great care must be taken to provide the right kind of incentives and that there is not now available adequate information to enable a categorical recommendation. Accordingly, the Exchange recommends that a proper study be made of incentives, to include tax incentives, designed to encourage the distribution and ownership of equities by all types of investors in Canada.

151. For example, the 20% tax credit does not extend to the large pools of institutional money, since most insurance companies and pension funds, as well as others, are non-taxable. However, since these organizations represent the savings of millions of Canadians, there should be some incentive which would make the purchase of Canadian equities attractive to them. This would broaden considerably the market for Canadian equities and also assist in maintaining control of Canadian operations in Canada.

SHARE SPLITS

151(A). (a) The Toronto Stock Exchange, either directly or through some of its members, has been urging listed companies to "split" their shares in order to keep their price at or below \$20.00 per share. A number of companies have taken such action.

(b) A survey made by one of the Exchange members in late 1959 of 1,000 of his clients disclosed the following information:

(i) At price levels of \$75.00 and up, only 23% of small investors (\$1,000 to \$5,000 range) are interested in buying "blue chips";

(ii) But if "blue chips" were split and offered at \$10.00 per share, 62% of small investors would prefer to own them instead of bonds, junior industrials or speculative issues. Ability to buy board lots is a major factor in the small investor's interest in this class of security;

(iii) In a "breaking" market, 48% of small investors would support the market for the "blue chips" if they were being traded in the \$10.00 range, but, at the higher levels, only 31% would buy as prices went down;

(iv) 80% of small investors show a preference for the products and services offered by a company in which they own shares;

(v) 84% of small investors show a preference for ownership of stock in companies which would issue quarterly financial reports over those which would not;

(c) An example of the effect of a stock split on the number of shareholders in a company may be seen in Dominion Stores Ltd. In the ten years from 1950 to 1961, the number of shareholders increased only from 3,300 to 3,700, i.e., 12%. But in 1961, the stock was split 5 for 1 and, within a year, the number of shareholders increased from 3,700 to 8,550 = 131%.

(d) It is suggested that the Bank Act be amended to permit banks to have their shares of nominal or of no par value

and thus permit them from time to time to split their shares.

It would probably be helpful, also, in this respect if the Commission would indicate the advantages (if they agree there are advantages) to the companies and to the public in having shares divided from time to time to permit them to sell in the range of \$20.00 or less. It is interesting to note a comparison between British and Canadian banks which was made in 1960:

	<u>Price</u> <u>Cdn.\$</u>	<u>Number of</u> <u>Shareholders</u>	<u>Market Value</u> <u>Average Shareholding</u> <u>Cdn.\$</u>
<u>British Banks</u>			
Barclays	8 ⁷ / ₈	61,000	3,337
Midland	12	65,000	2,988
Lloyds	9 ¹ / ₄	66,000	2,599
Westminster	8 ¹ / ₂	50,000	2,788
National Provincial	12 ¹ / ₄	42,000	3,062
<u>Canadian Banks</u>			
Royal	79 ¹ / ₂	22,200	21,624
Montreal	55	21,100	15,840
Commerce	55 ¹ / ₂	20,400	12,265
Nova Scotia	70 ³ / ₄	9,400	16,202
Toronto-Dominion	55	9,600	13,750

CHAPTER VI

TRADING FACILITIES AND PROCEDURES:

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TRADING FACILITIES AND PROCEDURES

GENERAL

152. The trading facilities provided by the Exchange in terms of plant and equipment are the equal of any stock exchange of which we have knowledge. The present building, erected in 1937, had installed in it a quotation enquiry system which has attracted world-wide interest. It is only in recent years, for example, that comparable systems have been devised for the New York Stock Exchange. The trading floor, of 8,500 square feet, provides facilities at nine trading posts for 590 more actively traded stocks and at three "inactive" posts for an additional 527 less actively traded issues. Trading activity in terms of the work to be processed on the floor and in subsequent recording and clearing operations can best be measured by the number of transactions executed during the course of a business day, and the present facilities have proven capable of adequately handling some 21,500 daily transactions.

TICKERS

153. One exception to adequacy of service is perhaps in the tickers. While the ticker system, with 411 tickers running in 76 towns and cities in Canada and 5 cities in the United States, is well distributed (see Appendix 18 for list and cost), the speed of present-day tickers is such that they cannot keep pace with peak market activity. A new type of ticker is now in course of development and the Toronto Stock Exchange hopes that, in the not distant future, this improved service will be available to its members.

QUOTATION SYSTEM

154. The dial quotation system provides for quotations to be printed out in subscribers' offices (in Toronto only) on some 590 listed issues within from 7 to 30 seconds of the time of dialling. The system has handled up to 75,000 enquiries on peak days. It is supplemented by a telephone enquiry system for the balance of the list.

155. In the past two or three years, a number of quote systems using electronic apparatus have been developed, and, at the present time, the Toronto Stock Exchange is actively considering the installation of such a system. This will give instantaneous quotations and other information throughout North America on all stocks listed on the Toronto board. It is expected that such a service will require a capital expenditure of close to a million dollars and will take almost two years to design and instal.

156. Another quotation system now available to members in Toronto is the "teleregister board". This is a console type of equipment which displays the last "bid" and "ask" on up to sixty selected stocks. The broker who has this board in his office will select, of course, the sixty stocks in which his clients are most interested. As the prices of these sixty stocks change on the big automatic board in the Exchange, they are at the same time automatically changed on the console in the brokers' office.

DATA PROCESSING

157. The use of modern communications and data processing equipment in the operation of the Exchange is also a constant study. The most promising areas for the advantageous use of such equipment appears to be in the processing of information, commencing at the point when a trade is made between two traders on the floor. Although speculative opinions have been given that the human element in the trading process might be eliminated altogether, this does not appear to be a possibility that need be taken into account in present planning.

CENTRAL DEPOSITORY

158. Studies are also being made on the feasibility and practicability of establishing a central depository for share certificates. This is an established practice in some European countries (France and Germany) and may well be capable of operating in Canada. Such an organization would probably be quite separate and apart from the Stock Exchange, but the Exchange and other financial institutions would certainly be involved in its operation.

BROKER'S RESPONSIBILITY IN TRANSACTIONS

159. When a member of the Toronto Stock Exchange is given an order by a client to buy or sell stock, there can be considered to be an unwritten contract between the two parties. On the one hand, the customer undertakes to buy (or sell) a specified number of shares of a given stock at the market or at a stated price. On the other hand, the member undertakes to use his best efforts for the customer in carrying out the transaction. Since the broker is a member of the Toronto Stock Exchange, which has a constitution, by-laws and settled modes of procedure, he, in carrying out the transaction, agrees to proceed in accordance with the by-laws and rules of the Exchange, and to execute the order with diligence and care.

METHOD OF EXECUTING AN ORDER

160. Orders to purchase or sell stock are normally placed either by telephone or by customers actually in the broker's office, or by mail or telegraph. Assume an investor in Fort William wishes to purchase 100 shares of Bell Telephone at \$52. He telephones his salesman, who is likely a representative of a national brokerage or investment house maintaining a small branch office in Fort William. The salesman will at once forward the order to the head office of his company in Toronto by direct wire. A ticket for the order is made out by the firm's traders on the stock trading desk in the Toronto office. The traders in the office then relay the order by direct private telephone to the company's order clerk in the firm's booth on the edge of the trading floor of the Toronto Stock Exchange. The order clerk then gives the order to the firm's floor trader.

TRADING "POSTS"

161. On the Toronto Stock Exchange, there are trading posts or locations. To each post is allotted a certain number of securities. Trading in these stocks must take place around these posts. In order to avoid congestion at any particular post, the most active stocks are, as far as possible, posted for trading in different sections. All transactions and markets on the floor

are made by open outcry of bids and offers. This is done to attract the attention of all traders who may be at that time busy dealing in other stocks at a different post. The moment a trader hears the stock called by another trader, all he has to do is go to that post and see if any of the bids or offers are meeting his order.

THE SEQUENCE IN A TRADE

162. The floor trader will therefore go to the post where Bell Telephone is traded and complete the transaction. The particulars of the trade are recorded on a floor ticket, which forms a permanent record of the transaction and is instantly transmitted to the ticker room, where the information is broadcast to all parts of the country over the ticker tape. As soon as the floor trader has completed the purchase of the 100 shares of Bell Telephone at \$52, he informs his firm's phone clerk in the booth at the edge of the floor, who phones the details to the trading room of the firm's Toronto office. The order is then completed and the customers' man in Fort William is informed by private wire that the order has been executed. The customers' man will then phone his client. An official confirmation of the transaction will be mailed to the client that same night from either the Toronto or Fort William office, depending upon the practice of the particular member organization.

TRADING RULES AND REGULATIONS

163. The Toronto Stock Exchange has developed very strict rules with regard to trading procedures and with regard to ethical standards of the members and member houses. Every effort has been made, and will continue to be made, to protect the interests of the buyer or seller of securities. Attorneys or floor clerks of the member firms are subject to a maximum fine of \$500, or suspension or expulsion from the trading floor, for any infractions of these rules and regulations. These rules follow the American rather than the British practice, with the important difference that Toronto has neither specialists nor odd-lot dealers. In the case of the London Stock Exchange, transactions are completed on a much less formal basis than in Toronto. While their members, in buying or selling, must give their transaction sufficient publicity to make its

existence generally known at the time, rules or regulations relating to the sequence in which orders must be filled (as is the case in Toronto) or to floor procedures generally are either very limited or non-existent (see Appendix 43 - By-Laws and Rulings on Trading - T.S.E. Circular No. 3).

FLOOR GOVERNORS

164. The Board of Governors of the Toronto Stock Exchange appoints floor governors to supervise floor procedures during trading hours. The floor governors have authority to make decisions whenever a dispute between members may arise over a transaction, and have power to discipline floor traders and clerks as noted above.

PRIORITY OF ORDERS FOR CUSTOMERS

165. An important ruling with regard to trading, from the standpoint of the protection of the public, was recently introduced by the Board of Governors of the Toronto Stock Exchange. This states that "Orders for the accounts of customers shall have priority over all other orders executed on the trading floor ... The phrase "orders for the accounts of customers ... shall not include an order for the account in which a member or a partner, director, officer, shareholder or employee of a member ... has an interest direct or indirect, other than an interest in a commission charged." At the time this ruling was made, it represented an important step forward in ensuring the public of complete priority in obtaining the best possible price in either the purchase or sale of a given security. As far as the Exchange can learn, Toronto was the first exchange to introduce such a far-reaching protective measure for the public benefit. It is understood that a similar ruling has since been adopted by other exchanges.

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SPREADS

166. The spread in the price of a stock is the differential between the bid and the asked prices. A stock which is \$50 bid per share and is offered at \$51 per share has a spread of \$1.00 per share or 2% on the bid price. The size of the spread in the market of various stocks will vary substantially in accordance with

a number of factors, the more important of which are stated below.

167. Factor 1 - Availability: The spread in the market of an issue with a relatively small number of shares outstanding is usually larger than the spread in the market of an issue with a large number of shares outstanding. Few people hold the stock and, therefore, few people are interested in it; consequently, it trades infrequently and, in many inactive issues, as long as a week will pass with no transactions. Inactivity naturally results in wide spreads, as there is no buying pressure to bid up the price to the offering side and there is no selling pressure to lower the offering price down to the bid. When inactive issues suddenly become active due to unexpected news, the spread will immediately narrow. The following are examples of spreads in the markets of relatively inactive industrial and financial stocks as compared with spreads in the markets of active stocks.

Spreads in the Markets of*
Inactive Listed Stocks

<u>Security</u>	<u>Bid Price</u>	<u>Offered Price</u>	<u>Dollar Spread</u>	<u>Percent Spread On Bid Price</u>
Imperial Life Assurance	\$121.00	\$134.00	\$13.00	10.7%
Dominion Lime Products	6.00	7.375	1.375	22.9
Niagara Wire	13.00	15.00	2.00	15.4
Cdn. General Electric	32.00	35.00	3.00	9.4
Anthes Imperial "A"	11.50	12.50	1.00	8.7

Spreads in the Markets of*
Active Listed Stocks

<u>Security</u>	<u>Bid Price</u>	<u>Offered Price</u>	<u>Dollar Spread</u>	<u>Percent Spread On Bid Price</u>
Calgary Power	\$ 20.375	\$ 20.50	\$ 0.125	0.6%
Salada Foods	12.875	13.00	0.125	1.0
Shawinigan Water & Power	22.25	22.50	0.25	1.1
International Nickel	68.00	68.25	0.25	0.4
Abitibi Power & Paper	44.75	45.00	0.25	0.6

* Prices as of May 31, 1962

168. Factor 2 - The Stock Price: Comparisons between high priced (above \$50 per share) and low priced (below \$15 per share) stocks indicate that, with all other elements (such as number of shares outstanding) equal, as prices increase so does the dollar spread in the market, but, at the same time, the percentage spread declines. This holds especially true of penny mining stocks where the dollar spread may be only one cent but the percentage spread may be as high

as 10%. The following table indicates typical dollar and percentage spreads of stocks in various price ranges.

	Average Spread	
	\$	%
10 active stocks selling above \$50 per share	1.0625	1.0971
10 active stocks selling below \$15 per share	0.215	2.7326
10 active mining stocks selling below \$1.00 per share	0.0065	4.3273

169. Spread in Preferred: Spreads in the prices of preferred stocks are usually very wide, because most preferred stock issues have only a small number of shares outstanding and most of the shares are held by long term investors. As preferred stocks are fixed income securities, they trade very little and, very often, there will be no offering whatsoever.

PARTICIPATION IN THE MARKET
BY "PROFESSIONALS"

170. A "professional" may be defined as a person who buys or sells for the short term - as a practice - or consistently - and not only on rare occasions. Naturally, he does this for a profit and therefore takes advantage of a market movement which he thinks unusual and unjustified. For example, the price of a stock may be unduly depressed by "panic" on the basis of an isolated bit of bad news about the company, or it may have a spectacular rise because of some favourable news story. The professional, in the first case, may buy, or, in the second case, sell or sell short. In either case, the action of the professional will probably have a stabilizing influence on the market, and he therefore tends to create the same result as the "specialist" is supposed to do in the United States markets. And it must be emphasized that not in all cases does the professional make a profit; this operation has in it a large element of risk, and, to have any success at all, the trader must be bold, skilful and experienced. Some members of the Exchange do professional trading, but there are no statistics available to indicate either the amount or the profits - if any - from such operations.

SPECIALIST TRIAL IN TORONTO

171. In an endeavour to give the best possible service in filling orders for clients, it was decided to try out the specialist system in Toronto three years ago. However, the practice was discontinued when it was found that the specialist, in fact, served no useful purpose in our market, where the value of the shares is, on the average, very much less than in New York and where the broker here is, to a large extent, fulfilling the role of both the jobber and the broker in London. It is interesting to note in this connection that discontinuance of the "jobber" system in London is now being considered as being unnecessarily cumbersome, and there is some doubt as to the need for, or the efficiency of, the specialist in New York. The large underwriting houses which have stock exchange affiliates may from time to time have substantial positions in issues which they have underwritten or sponsored and, to this extent, act as "specialists", but these positions, as a rule, are of a temporary nature. Very few member firms maintain large investment positions in equities for their own accounts (see Chapter IX).

THE TORONTO STOCK EXCHANGE
DOLLAR AND SHARE VOLUME

172. The number of shares traded on the Toronto Stock Exchange has fluctuated in a wide range during the past ten years, but there has been a noticeable uptrend as shown in the table at Appendix 19. The heavy volumes recorded during 1955 and 1956 were largely due to the activity of the mining and western oil stocks in those years. Mining and western oil stocks still have an important - but, in recent years, a declining - influence on the Toronto Stock Exchange as illustrated by the following statistics:

The Toronto Stock Exchange Mining & Oil Share Volume and Value as a Percent of Total Volume and Value		
<u>Year</u>	<u>Share Volume</u>	<u>Share Value</u>
1961	86.8%	29.8%
1960	90.7	33.6
1959	91.3	38.5

The Toronto Stock Exchange
Industrial and Mining Volume and Value

Year	<u>Industrials</u>		<u>Mines and Western Oils</u>	
	<u>Share</u> <u>Volume</u>	<u>Dollar</u> <u>Value</u>	<u>Share</u> <u>Volume</u>	<u>Dollar</u> <u>Value</u>
1961	95,077,878	\$1,772,758,204	624,243,098	\$753,591,665
1960	43,758,216	812,338,748	425,933,327	410,991,746
1959	66,114,430	1,114,209,434	697,120,181	716,212,893

173. The relative position as to volume and values of the mining and western oil stocks listed on the Toronto Stock Exchange is declining due, in part, to the development in Toronto of a large industrial market. It is anticipated that this trend will continue as Canadian secondary and heavy industry expands - although Toronto should still continue to hold a pre-eminent place as a mining and oil share market relative to other exchanges in Canada.

SIZE OF TRANSACTIONS

174. The size of the typical transaction on the Toronto Stock Exchange varies in a wide range. Regular trading units or "board lots" are as follows:

MINING SHARES

Shares selling under \$1.00:	500 shares
Shares selling at \$1.00 and over:	100 shares

OTHER SHARES

Shares selling under \$25:	100 shares
Shares selling at \$25 and under \$100:	25 shares
Shares selling over \$100:	10 shares

175. Individual or retail orders to purchase industrial stocks are usually for 100 shares, while orders for institutions are rarely for less than 1,000 shares. Large institutional orders, i.e., for 10,000 shares or more, are usually executed over a period of days, and very large orders are generally distributed among a number of members of the Exchange.

CHAPTER VII

PRIMARY DISTRIBUTION AND SECURITIES LEGISLATION:

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PART I

PRIMARY DISTRIBUTION

176. For definition as in The Ontario Securities Act (Sec. 1(1)), see Appendix 20.

REQUIREMENT FOR PROSPECTUS
WAIVED FOR LISTED STOCKS

177. Sections 38, 39 and 40 of the above-noted Act require the filing of a prospectus with the Securities Commission before "primary distribution", but Section 41(b) of the Act states that Sections 38, 39 and 40 do not apply to securities "that are listed and posted for trading on any recognized stock exchange when such securities are sold through such stock exchange." It is as a result of this Section 41(b) that the Toronto Stock Exchange is responsible for supervising the primary distribution of shares of some of its listed companies, i.e., those engaged in mining and oil production. On the other hand, it has always been the accepted practice in Ontario that primary distribution of securities in the industrial category will be made only after filing a prospectus with the Securities Commission, notwithstanding Section 41(b).

INDUSTRIAL PRIMARY - BY PROSPECTUS

178a. As a result of the above-noted long-established practice, the Toronto Stock Exchange lists only the issued capital of industrial companies; hence, if such a company wishes to raise further funds by the issue and sale of additional treasury shares, this must be done off the Exchange by a public offering accompanied by a prospectus which has been filed with the Securities Commission - in other words, the shares are traded on the Exchange only after they are issued and in the hands of the public.

INDUSTRIAL PRIMARY - NOT BY PROSPECTUS

178b. But it must be noted that "primary distribution" by the Securities Act definition (Sec. 1(e)(ii)) includes trades in "previously distributed securities" under certain circumstances, i.e., where control of a company is involved. In such cases, blocks of such securities may be distributed with permission of the Toronto Stock Exchange off the floor of the Exchange, such permission

being only granted in special circumstances; for example, when the stock to be sold and the actual sale on the floor of the Exchange might unduly depress the price of the security. In spite of the fact that the transaction takes place off the floor, under certain prescribed rules, such sale is considered to be made "through the facilities" of the Toronto Stock Exchange and, therefore, a prospectus need not be filed.

MINING AND OIL PRIMARY - EXCHANGE RESPONSIBILITY

179. Unlike the practice with industrials, the Exchange requires the initial listing and posting for trading of the entire authorized capital of mining and oil companies, whether issued or not; hence, should this type of company wish to raise further capital by the issue and sale of additional shares, it may do so only with the consent of, and on terms agreeable to, the Exchange - and, although a prospectus is not required, there must be very complete disclosure as discussed hereunder. Thus, the Exchange has assumed an extremely onerous responsibility, which at present represents possibly 90% of its regulatory activities.

REGULATING MINING AND OIL PRIMARY

180. The efforts of the Exchange to supervise, regulate and control this type of primary financing have been devoted to two principal areas:

(a) Option and underwriting terms which must be met by persons or companies concerned (see Exchange Circular No. 5 at Appendix 21).

(b) Full disclosure of all material facts through the medium of a "filing statement". (Sample form at Appendix 22 and Ruling 49 at Appendix 23).

181. Option and Underwriting Terms: It will be noted that under Circular No. 5 the following rules, inter alia, apply (these have been developed over the years as the result of experience and after discussion with the Securities Commission):

(a) An option without an underwriting shall not be accepted;

(b) An underwriting in almost all cases must be

payable in full forthwith;

(c) The minimum underwriting or sale price shall be 15¢ a share except under exceptional circumstances or following a capital re-organization involving a change of name and consolidation of shares;

(d) The amount of an underwriting shall normally be not less than \$30,000;

(e) The initial price at which an underwriting can be made is limited as to the amount of discount allowable from the current market;

(f) Not more than 1,000,000 shares can be included in any one agreement, and not more than 200,000 shares can be acquired at any one price, except that an option on 200,000 shares may be permitted at the same price as the underwriting provided the underwriting is for 200,000 shares;

(g) Price spreads between options are to be at not less than 5¢ per share up to 50¢, not less than 10¢ per share from 50¢ to \$1.00, and not less than 25¢ per share thereafter;

(h) Individual option instalments shall come due at intervals not exceeding three months, and the whole agreement shall not embrace a period longer than eighteen months;

(i) Acceleration of the time at which options become due is provided for in the event of a sharp rise in the market price of the shares;

(j) No underwriting or option agreement will be accepted which does not provide for notice being given to the Exchange of any sub-options or sub-underwritings prior to their being entered into (this includes the names of all parties who have a legal or beneficial interest);

(k) The underwriter, who must be a member of the Exchange or a registrant with the Ontario Securities Commission, takes full responsibility for the actions of

any sub-underwriter or sub-optionee, and he is held to account as if the latter's actions were his own.

182. Filing Statements: Like a prospectus, the filing statement must make full disclosure. It must disclose not only the information concerning options and underwritings, but every other item or action that will result in any material change in the business or affairs or control of the company. A "Filing Statement Committee" of eight members (three of the present Committee are members of the Board of Governors) meticulously examine each statement and "accept" it for filing, or reject it. In the latter case, the company may not proceed with the proposed option - underwriting or other act - and, if it should persist in doing so, its shares will be suspended from trading or be delisted.

To give expert advice and so assist the Committee, a highly qualified mining engineer has been retained on an annual basis; the same man is a consultant with the Securities Commission.

Examples of information in filing statements are: a) any payments made or proposed to be made to a promoter or finder in connection with a proposed underwriting or property acquisition; b) a brief statement of the company's future development plans, including proposed expenditures to be made from the amount raised by an underwriting; c) the company's chief development work during the past year; d) the names and addresses of any vendors of any property or assets to be purchased, and the amount of the consideration paid or to be paid; e) the names and addresses of persons who have received or will receive a greater than 5% interest in the consideration; f) the terms of any escrow agreement, the number of shares escrowed, and the names and addresses of anyone holding a more than 5% interest in escrowed shares; g) the names and addresses of the five largest registered shareholders; h) the names and addresses of persons whose share holdings are large enough to materially affect control of the company; i) a statement of investments in other companies held by the subject company, showing the cost or book value and the present market value thereof; j) a statement of any lawsuits pending; k) the dates, the parties to and the

general nature of every material contract which is still in effect and not previously disclosed.

183. Exempted Companies: If a company is well-established and is unlikely to resort to primary financing through the Exchange, the Board of Governors may exempt it from submitting filing statements, and, indeed, at present only some 400 companies of the more than 1,000 listed come under Ruling 49; most of these are mining and oil companies in exploration or early development stage and have in the past resorted to, or are likely in the future to resort to, primary distribution. It is interesting to note that, in 1961, a total of 183 filing statements (including amending statements) were dealt with by the Committee.

184. Publicity: These filing statements are available to the public; copies go to all members of the Exchange and to the press. The Exchange makes every effort to ensure that in these statements there is complete information such as might be of value to an investor, to the shareholders and to the public at large. There is some disappointment on the part of the Exchange that there is not more apparent use of such information by news media and by shareholders of the companies concerned.

A major portion of the administration of the filing statements has been in regard to so-called non-arms-length transactions between the directors or officers of the companies and the companies themselves. This is a particularly sensitive area and one in which shareholders are more appropriate complainants, either to the company or the courts, than the stock exchange, which is open to the accusation that it is attempting to run the internal affairs of listed companies. Shareholders' actions of this sort, however, have been notable by their small number.

SCRUTINY OF ANNUAL REPORTS

185. The Exchange carefully reviews the annual financial reports of these companies to ascertain if money raised has been spent for legitimate purposes and in conformity with the intentions expressed in the filing statements. This goes beyond what is undertaken by the Ontario Securities Commission or the Companies Branch of the

Provincial Secretary's Department, and has been the cause of criticism from companies concerned as being unwarranted "meddling" in company affairs, but the Exchange considers it an essential duty. In several recent cases, the Exchange has noted, for example, from the material submitted, what it considers to be excessive salaries and administrative charges not warranted by the company's activities and has insisted that they be reduced or eliminated.

"NON-ARMS-LENGTH" TRANSACTIONS

186. As intimated in para. 184 above, the Exchange is much concerned with the arms-length character of a proposed transaction. Because it was found that, in some cases, properties or other assets were being purchased by companies from interested parties at what appeared to be unconscionable prices, a ruling was recently passed by the Toronto Stock Exchange which reads as follows:

"In a transaction between a non-exempt company and a vendor who is a director, officer or major shareholder, the assets sold to the company shall be for a cash consideration no greater than the vendor's costs. If such vendor has owned the assets for twelve months or longer, in addition to the cash consideration, shares may be issued which are 100% escrowed. In both cases, the transaction shall be subject to the approval of shareholders at a meeting for which the notice shall set out all material details of the transaction.

The Filing Statement Committee shall have discretion at all times in imposing the above restrictions on such a transaction."

Discretion as to the application of this ruling had to be left with the Filing Statement Committee, because the Board of Governors were aware that there would be cases where a director, an officer or a principal shareholder might own property which subsequently became very valuable and which he should sell to his company, and for which, in all fairness, he should receive more than his out-of-pocket expenses. In other cases, the Exchange has required the approval of shareholders before accepting a filing

statement where it considers that the conflict of interest should be brought to the attention of shareholders.

ESCROWS

187. Escrow agreements to which the Toronto Stock Exchange always becomes a party, covering shares in listed companies, also afford considerable protection to the public. These agreements usually have to do with vendor's shares. The Stock Exchange permits a release of one-third of these shares at six-month intervals only if sufficient money has been actually spent on the development and exploration of the property concerned. Where properties are abandoned before sufficient work has been done, the Exchange often requires a return to the treasury of at least some portion of the vendor's escrowed stock, prior to allowing a new underwriting.

MAINTAINING ORDERLY MARKET

188. The Stock Exchange, when it considers that there are not enough shares in the hands of the public to assure an orderly market, requires the underwriter to distribute the shares underwritten or optioned at prices not greater than what would be considered a reasonable mark-up from the take-down price; and, before continuing with the underwriting agreement at higher prices, the underwriter must submit proof of satisfactory distribution of those shares below the range stipulated. At all times, an underwriter is held to account for the orderliness of the market in the underwritten shares and he may be penalized if, following distribution, he completely ignores the market for these shares.

RESULTS OF PRIMARY FINANCING ON THE TORONTO STOCK EXCHANGE

189. (a) 1952 to 1961: It is difficult to assess the significance of the money raised in this way, nor are figures or results available for comparison as to capital raised from the sale of "unlisted" mining securities over-the-counter. From 1952 to 1961, we do know that \$366,661,784 was provided for 352 listed mining companies by the underwriting or optioning of their treasury shares. Of these companies, 327 are still listed, 23 have been delisted for a variety of reasons, and 2 have become industrials.

(b) 1957: A study was undertaken of the 126 mining

companies financed through Exchange facilities in 1957, and it was found that the amount received from options and underwritings was \$53,060,832. 33 of these companies eventually became producing mines for at least a period of time; 4 (of which 3 are uranium producers) have achieved production in excess of \$50,000,000 each since 1957; 20 companies have each had gross production of \$1 million to \$50 million; and 9 companies have each produced less than \$1 million. Obviously, this method of raising funds is of prime importance to the companies concerned.

SUMMARY

190. The above paragraphs 180 to 188 indicate generally the methods applied by the Toronto Stock Exchange in attempting to discharge its responsibility to supervise, regulate and control primary distribution through the Exchange. Many other Exchange regulations, of course, also apply to this type of stock transaction and lend strength to the Exchange's difficult task of protecting the investor and at the same time not strangling or unduly obstructing the flow of capital for the development of our natural resources.

191. Alternative Methods of Primary Financing:

(a) Many people - in fact, many members of the Toronto Stock Exchange - would remove this practice of primary distribution from the Exchange and leave the Exchange to pursue its true function of a market place for securities already in the hands of the public. Such a course would remove what appears to be the anomalous situation which now exists where, on one hand, the Exchange strives to improve and increase the public interest and regard for equities, and, on the other hand, must act as a medium for the financing of highly speculative enterprises.

(b) The alternative would be primary financing of the mining and oil ventures by prospectus under the direct control of the Securities Commission. We say "direct control" because, of course, even now, the Commission is the superior authority and the Exchange operates always subject to the overriding legislative regulations administered by the Commission, with whom the Exchange always works in harmony and close co-operation.

192. It is difficult to see how the Commission could do much more than the Exchange is now doing, although, of course, the Commission staff would in no way be affected by the results of their decision to accept or reject a prospectus and the attendant plans for financing the enterprise, whereas the members of the Stock Exchange who sit in judgment on these matters may be - and often are - indirectly affected, i.e., on the assumption that the more stocks listed, the more trading there will be. The only answer to this is the fact that the members of the responsible committee are scrupulously honest and objective in their consideration of the proposals that come before them; more than this, there is no doubt that the experience of at least some members of the committee in the vagaries and intricacies of this type of financing, and their personal knowledge of people in the industry - promoters, underwriters and optionees - are of great value.

193. Perhaps it is no more than fair to say that although these members seem to "lean over backwards" in trying to ensure that the investor gets a fair deal, they are, in fact, indirectly acting in their own self-interest, because they realize that a "bad" deal is bad for the investment industry, bad for the Exchange, and that means bad for their business.

194. It is quite certain that any alternative method of arranging primary distribution would be subject to the following disadvantages when compared to the present system:

(a) The use of a prospectus would be very much more expensive because of printing and legal fees;

(b) The processing by the Securities Commission under present regulations would require an independent audit of the company's finances, which would add to the cost. The Exchange accepts the certificate of the company auditors;

(c) There would be a lack of discretion and flexibility in processing through a government agency;

(d) There would be much longer delay in getting approvals,

CONCLUSION

195. It is doubtful indeed that any public servant, judicial or

administrative, would act more decisively - or more objectively - or with more experience - or with greater consideration for the investor - than do the Governors and their Committees.

It is suggested, therefore, that the present system of primary distribution be left as it now is.

PART II

PRESENT CANADIAN LEGISLATION

196. Each of the ten provinces now have a Security Act and, in addition to this, there is the Dominion Companies Act, a number of Provincial Companies or Corporations Acts and Companies or Corporations Information Acts; all might be considered, in part at least, "security legislation". The fraud provisions of the Criminal Code also has to do with security dealings (wash-selling, etc.)

197. In Ontario, "The Securities Act" (R.S.O. 1960, Ch. 363) and, supplementing it, Regulation 543 (R.R.O. 543), has been in force since 1945 - although frequently revised. The provisions of the Act have been closely followed in the security statutes of Alberta, Saskatchewan and Quebec, and it is understood that British Columbia and New Brunswick may shortly adopt legislation of a similar pattern.

TREND TO UNIFORMITY

198. This trend to uniformity of legislation in the security field is more evident than in other areas, e.g., corporate law, and there is good reason to assume that the trend will continue. Experience has shown that as security business became more prevalent and important in any province, the need for regulations became apparent. The natural course to be taken by the province concerned was to draft and enact legislation very similar - if not in exact terms - to statutes in other provinces which had been tested and proved by practice and experience.

THE ONTARIO SECURITIES ACT

199. This is both a "regulatory" and a "full disclosure" type of statute; that is to say, it provides for a commission of three who have wide powers of regulating the industry by:

(a) the approval and registration of practically every person in any way connected with security issuing or trading;

(b) the investigation of individuals' or companies' books and affairs generally;

- (c) consenting to the operation of a stock exchange;
- (d) accepting - or rejecting - prospectuses, etc.,
etc.

It is a "full disclosure" type because it sets out in Sections 38, 39 and 40 the "full, true and plain disclosure" which is required of each company before the distribution of its shares to the public.

CO-OPERATION AMONG PROVINCES

200. In recent years, there has been an ever-increasing degree of liaison and co-operation between the various provincial commissions or other relevant authorities. The exchange of information extends to reports on individuals, registered or denied registration; to administrative procedures and techniques; to suggested amendments or modifications to bring uniformity in law and regulations, and in other areas of mutual interest. There is a North American Association of Securities Administrators which meets annually, and, in addition, the Canadian Administrators meet annually to exchange opinions, discuss mutual or individual problems and collaborate generally.

UNITED STATES SECURITY LAWS

201. There may be said to be four types of securities statutes in the U.S.A: a) The Securities Act of 1933, which is a "full disclosure" type of law pertaining to the initial sale of securities only after certain, and very complete, information is given to the public; b) The Securities Exchange Act (1934) dealing with the regulation of trading after the primary distribution, i.e., after the security is in the hands of the public; this Act regulates the stock exchanges; c) The State Security Laws - and there is one in almost every State - originally known as "Blue Sky Laws"; and d) Uniform Securities Act (1958), which has been adopted by some of the States in whole or in part and replaces the former "Blue Sky Law" of the State concerned. This Act is comparable to the Ontario Securities Act.

PROBABLE FUTURE CANADIAN COURSE

202. Had we in Canada 48 or 50 provinces with 48 or 50 statutes, with commissions or administrators - and policies - subject to the

political whims of the 48 or 50 electorates, it is quite certain that the investment industry of Canada would favour federal legislation and control. However, we have but ten provinces; four - or perhaps six by this time - have practically uniform security legislation; all ten consult and exchange information, as necessary; and experience has shown that as additional provinces find that they need more refined and perhaps more drastic legislation, they will probably follow closely the provisions of the Acts in the four or six provinces as referred to above.

FEDERAL LEGISLATION

203. One hears in Canada occasionally the suggestion that we should have a federal law similar to the Securities Exchange Act, and the implication is that such a statute would render a great service to our investment industry. This, of course, is not necessarily so. Experience has shown that in the United States their legislation does not remove completely breaches of ethical or legal codes., e.g., the recent exposures of some specialists and other irregularities in the operations of the American Stock Exchange. It is true, of course, that under the S.E.C. there are some requirements (for example, with respect to disclosure of directors trading in the shares of their company, or the disclosure of those interested in "take-over" bids, to name two) which might well apply to Canadian companies or stock exchanges. But a federal law to compel such disclosure and perhaps other desirable terms is not necessarily the answer; this can be, and no doubt will be, accomplished in due course, as other refinements in our practices have been introduced - when the need and demand is apparent - by either provincial act or stock exchange and/or I.D.A. regulation.

204. If, by federal securities legislation, we could assume the substitution of a federal act and department for the ten provincial acts and administrative departments, there are some in the industry who would acknowledge an immediate advantage in this by removing duplication and establishing a higher degree of uniformity of administration and of the law than exists at present. But if it meant the addition of one more piece of security regulation, with

one more department superimposed on those now existing, it would meet with the strongest opposition from the industry. To justify federal legislation and administration, the problem of security regulation must be identified as a national problem. In Canada, this is not the case. It is in great measure a local problem, particularly in the matter of registration of brokers, etc., and can best be dealt with at that level.

205. The Securities and Exchange Commission has brought some semblance of order out of the chaotic mass of security legislation and regulation which existed prior to 1933, but, at the same time, it has imposed delays and expense upon the investment industry which, it is hoped, will never be experienced in Canada.

206. The important feature which one must keep in mind when thinking of Federal Securities Legislation is that with the legislation must go the burden of administration. And in any federal department charged with the administration of a set of regulations, there is a well-known propensity to keep the power of decision at the "summit"; there is an antipathy to the delegation of authority and, even where there is delegation, there is a vast reluctance on the part of the "delegate" to make decisions. Such a philosophy applied to securities administration across Canada would lead to expense, delay and frustration which could not help but militate against the proper functioning of securities markets.

IMPROPER SALE OF CANADIAN
SECURITIES IN U.S.A.

207. The only feature of the securities industry which might be regarded as a national problem in the past has been the sale of Canadian securities in the United States, resulting in the contravention of American laws. But even this problem can be effectively dealt with by such action as was taken in this province by the industry itself, and by the measures adopted by the Securities Exchange Act in the United States in regard to the withdrawal of the use of the mails. In March of 1961, the Broker-Dealers' Association of Ontario, at the instigation of and after "urging" by the Toronto Stock Exchange, prohibited their members from selling securities in

the United States in contravention of the U.S. laws. This action has virtually eliminated this type of activity in or from the Province of Ontario and incidentally resulted in a considerable number of broker-dealers going out of business. It should be noted that the Exchange does not allow persons who have violated the laws of other jurisdictions in the distribution of shares to take part in primary distribution through the Exchange.

208. In summing up, then, it might be said that the work already done in the field of security legislation has achieved most of the desired results with little or no disruption of normal business and a minimum of expense to the taxpayer or security issuer. The Chairman of the Ontario Securities Commission, in the administration of his office, has acted with a minimum of discretionary powers, but with scrupulous regard for the Act and with dedicated devotion to the rule of law, resisting all temptation to rely on administrative fiat. The infrequency of appeals from the Commission's rulings and the uniform lack of success of any such appeals are eloquent testimonials to the effectiveness of the securities administration in Ontario.

CONCLUSION

209. The Toronto Stock Exchange is of the opinion that a Federal Securities Act is neither needed nor justified, but does suggest that the Federal Government urge upon all Provincial Governments the need for uniform securities laws and similar administrative regulations.

MARKET MANIPULATION

209A. Sec. 323 and Sec. 325 of the Criminal Code (see Appendix 47) both refer to offences related to the "manipulation" of stock prices. Item "C" of Sec. 3 of By-Law 11 of the Exchange (Appendix 24) refers to the same subject. During the past three years, there have been only two prosecutions under the Criminal Code; one resulted in a trial and re-trial with two hung juries, and the other resulted in a "guilty" plea and conviction for fraud. There have been no charges laid under Item "C" of Sec. 3 of By-Law 11. All the above indicates that if there is market manipulation, it is extremely difficult to identify and, even if identified, it is difficult to prove.

209B. Perhaps the difficulty in identifying and proving market manipulation is due largely to the fact that it is quite proper to carry out transactions which may materially affect the market but which are considered legitimate and are part of the normal workings of a free market. It is extremely difficult to differentiate between these and those other transactions which are carried through with the intent to manipulate and deceive.

209C. To legislate adequately against manipulation is indeed difficult. It may be useful for the Commission to take note of Sec. 9 of the United States Securities Exchange Act at Appendix 48. This deals with manipulation of security prices, and a comparison with our Sections 323 and 325 of the Criminal Code might indicate that Sec. 325 should be amended or extended to include some of the provisions of the said Sec. 9 - for example, 9(2).

209D. The Exchange suggests that the Commission might recommend that the Department of Justice study this subject and, after consultation with Stock Exchanges, Provincial Securities Administrators and others, decide whether or not amendments to the Criminal Code are needed.

PART III

THE T.S.E. AS A SELF-POLICING ORGANIZATION

210. It is frequently said that the Toronto Stock Exchange is a self-policing organization. This, to a large extent, is true and derives from the Act of Incorporation (1878) and Supplementary Letters Patent (1941); these extended the powers and objects of the Corporation, viz:

"To enact by-laws, not contrary to law, for the constitution, government, control, regulation and management of the franchises, rights, privileges, contracts, obligations, transactions and affairs of the Corporation and of and between the members, and to impose penalties and forfeitures in respect thereof."

It may be of interest and useful to set out here some of the regulations which the Exchange has imposed upon, and enforced against, its members in its efforts to carry out these responsibilities.

BY-LAWS AND RULES AFFECTING MEMBERS

211. (The first figure is the number of the By-Law, the second figure the section):

- (a) No member may form or maintain an affiliated company without the approval of the Board (1 - 4(a));
- (b) A seat may not be transferred, pledged or mortgaged without authority of the Board (1 - 6);
- (c) A member's seat shall be held in trust for the firm or corporation (and their creditors) of which the member is a partner or director (1 - 6);
- (d) The Board may - and does - either as a result of a complaint or of its own volition, investigate the conduct of a member or any of his partners, or may appoint any other person or an auditor to investigate (10 - 2) (13 - 5);
- (e) If any member shall be adjudged by the Board of Governors guilty of a violation of any of the By-Laws or Rules or Regulations of the Corporation, or of failure to

obey or conform to any decision of the Corporation or the Board, or of any conduct, proceeding or method of business which the Board in their absolute discretion deems unbecoming a member of the Exchange, or inconsistent with just and equitable principles of trade, or detrimental to the interests of the Exchange, the Board may impose any one or more of the following penalties, viz: (1) a fine not exceeding \$15,000, (2) suspension for such period or periods and upon such conditions, if any, as the Board may determine, and (3) expulsion; and, in addition thereto, may declare forfeit the seat and membership of any member expelled (11 - 1).

Note: For definition of "conduct unbecoming, etc...", see Appendix 24.

(f) A member is liable for the acts of his employees - and his partners or directors and officers, if he is a member of a corporation (11 - 2);

(g) Attorneys representing the same member may not trade or compete with each other in the making of bids or offers at the same time in the same security (12 - 2);

(h) Attorneys must be approved by the Floor Procedure Committee; their appointment is renewed each year and may be revoked at any time (12 - 5-6);

(i) Attorneys may be fined up to \$500, suspended or expelled for unethical conduct (26 - 9). For definition, see Appendix 25.

(j) No member may form a partnership, admit a new partner or permit a partner to retire, or dissolve or change the name of a partnership, or open a branch office, without the Board's approval (13 - 1) (38);

(k) If a member defaults in his liabilities or engagements to the Corporation or to the Clearing House, or to another member, he may be suspended by the Board; if a member becomes bankrupt, he is automatically suspended

(21 - 2-9);

(l) Members and their attorneys must operate under the trading regulations described in Chapter 6 of this brief;

(m) Members must carry a blanket fidelity bond in amounts determined by the Board (28);

(n) Members must maintain, for each client having a margin account, a form of agreement as approved by the Board and signed by the client.

(o) Audits of members' financial affairs are carried out at such times and in such a way as the Board or Exchange Auditor may direct. In addition, the Board requires each member to file periodically with the Exchange answers to a financial questionnaire. Following this, the Exchange Examiners, who are Chartered Accountants in the employ of the Exchange, make a physical check of the books, records, accounts, customers' securities, etc., in the members' offices. The Exchange Auditor and the Exchange Examiners then report to the Audit Committee and, if a financial situation is not satisfactory, the Board may suspend the member;

(p) The Board may require a panel auditor, the Exchange Auditor or Examiners, to regulate and supervise the operations of a member;

(q) The Board may require a member to change his system of bookkeeping or record keeping;

(r) The Board determines the amount of net free capital to be had by members;

(s) Advertising by members (press, radio or television) is controlled (47);

(t) Employees who deal with the public (salesmen or customers' men) must be approved by the Exchange (49);

(u) The Board requires a report on short positions as of the close of business on the 15th and last day of each month (56) and a statement of outstanding loans each

month (60).

212. The above regulations have been developed over a period of many years; some have been passed quite recently; others will no doubt be added as time goes on. It is the policy and determination of the Exchange that its affairs shall be conducted in accordance with the highest principles of ethics as an efficient quasi-public institution. It may be noted that, having regard to the type and volume of transactions, the lack of written contracts, the amounts of money involved in every day of trading, and the immense sums involved in a year's trading on the Exchange, there are extremely few complaints or allegations of malpractice.

REFERENCE LISTED COMPANIES

213. The above refers to members, and the regulations affecting the listed companies - and comments thereon - are discussed in Chapter VIII below.

CHAPTER VIII

THE LISTED MARKET AND OVER-THE-COUNTER TRADING:

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PART I

THE LISTED MARKET

EVOLUTION OF LISTING POLICY

214. Listing policy or the determination of the qualifications for listing on the Toronto Stock Exchange has been under continuous development over the past ten years. Although they can only be described in general terms, the tendency has been to increase the requirements while the listing of both industrial and mining and oil issues have remained in about the same proportion (see para. 222 below). There is a constant revision of the stock list occurring, as well as net changes reflected in the total listings.

FLEXIBILITY IN POLICY NECESSARY

215. The Exchange does not wish to develop a list of highly speculative industrial issues, but, at the same time, it is conscious of a responsibility to provide a market place for smaller industrial companies. Between these two objectives, a listing policy has been evolved, not always with absolute consistency, as it is felt that a considerable measure of flexibility is highly desirable in this field and that the combined experience of a representative segment of the industry provided by the members of the Listing Committee is well qualified to exercise such discretion to the best advantage. The Exchange policy endeavours to ensure that all companies deserving or worthy of listing will be accepted.

INDUSTRIAL QUALIFICATION

216. Industrial listings are now considered on the basis of the earning record of the company, proof of consistent earnings being regarded as removing the security from the highly speculative field. However, if a company cannot show earnings of sufficient consistency but can show net tangible assets of over \$1,000,000 and working capital of \$250,000 or more, and can provide a projection of earnings satisfactory to the Listing Committee, the Committee may consider it a case for exercising a large measure of discretion.

MINING AND OIL QUALIFICATION

217. On the mining and oil section of the list, a similar evolution of policy has taken place, also in the direction of higher listing

requirements. In the case of mining enterprises in the exploratory phase, companies are considered eligible when they have carried out preliminary exploratory work by diamond drilling and other means so that they are able to provide a competent engineer's report recommending a programme of shaft-sinking or adit construction to test the indicated ore-body by underground testing. The company must also be able to show cash on hand or a proposed plan to raise sufficient funds to carry out the recommendation. As this stage of development does not ensure a successful mining enterprise, it is inevitable that this listing policy will result in a number of dormant mining listings which have proven their properties to be uneconomic in the course of carrying out the programmes projected by them when listed. So far, it has proven impossible to develop a minimum standard of performance which would have to be met to permit such companies to remain on the list and which would be equitable to both existing and future shareholders, although some progress has been made in that direction. It is felt, however, that the listing of a company at this stage of its development gives the public shareholder a fair "run for his money".

OIL AND NATURAL GAS QUALIFICATION

218. Listing requirements as applied to oil and natural gas producing companies developed rapidly as western oil discoveries were accelerated in the early 1950's. It, too, has been a progression in the direction of increased requirements. The selection, as in the case of mining companies, has left a number of dormant or nearly dormant companies on the list. A greater trend toward mergers has reduced their number, perhaps to a greater extent than in the case of mining companies. Present policy would seek to make a selection among small companies on the basis of adequate financing and a sufficient cash flow to ensure the continued life of the company. Experience would suggest net cash resources of about \$200,000, net cash flow of \$25,000 to \$50,000. This would mean net reserves of 750,000 to 1,000,000 barrels of light oil on a 4% annual production rate.

OTHER FACTORS RE LISTING

219. In addition to these particular measurements applied to

applicant companies, such factors as distribution sufficient to provide an adequate auction market, the sponsorship of new issues and the total market value of shares in the hands of the public must of necessity be taken into consideration.

COMPARISON WITH NEW YORK

220. A comparison with the standards of eligibility for listing on the New York Stock Exchange, while it may be of interest, does not prove to be particularly helpful. The American Stock Exchange listing regulations have been less restrictive than Toronto, but are now being revised with a view to setting a higher standard. Yardsticks on the New York Stock Exchange such as \$1,000,000 of demonstrated annual earning power after all charges, including taxes, and net tangible assets of at least \$10,000,000 or aggregate market value of common stock of \$10,000,000, merely serve to emphasize the disparity in size of the T.S.E. and N.Y.S.E., and the industry of the two countries. The New York Stock Exchange seeks to provide a market place for the major nationally known domestic and foreign corporations with shareholder lists of 1,500 or more.

221. There are five Canadian industrial companies and six mining companies with shares listed on the New York Stock Exchange and on the Toronto and Montreal Exchanges. Relative trading volume in these issues on the three exchanges is shown in Appendix 45. An analysis of trading in interlisted issues on the Toronto, American and New York Stock Exchanges is given in Appendix 44, which serves to indicate the extent of trading in Canadian issues on American exchanges. (Note: There are now 33 industrials and 54 mines inter-listed on the Toronto and American Stock Exchanges.)

NUMBER LISTED ON T.S.E.

222. At December 31, 1961, there were 1,117 issues on the Toronto Stock Exchange. Of this total, 620 were industrials and 497 were mining and junior oil stocks. During the period between December 31, 1950, and December 31, 1961, the number of listed industrial stocks increased by 107 or 21%, and the number of listed mining and oil stocks increased by 95 or 21%, as shown below:

Year	Industrials		Mines and Western Oils		Total Listings Dec. 31
	No. of new companies listing	No. of stocks listed at Dec. 31	No. of new companies listing	No. of stocks listed at Dec. 31	
1948	12	493	13	357	850
1949	7	503	12	364	867
1950	13	513	41	402	915
1951	14	517	59	440	957
1952	13	536	56	479	1,015
1953	12	532	37	503	1,035
1954	13	529	21	518	1,047
1955	14	534	24	536	1,070
1956	29	569	32	554	1,123
1957	20	597	15	546	1,143
1958	9	608	6	522	1,130
1959	25	614	17	517	1,131
1960	13	617	6	501	1,118
1961	18	620	6	497	1,117

ISSUES TRADED DAILY

223. The number of different issues traded on the Toronto Stock Exchange during a typical day varies in a wide range, as illustrated by the following statistics:

<u>Period</u>	<u>Most Active Day</u>	<u>Least Active Day</u>	<u>Average</u>
January 1962	724	574	695
May 1962	805	555	667

The number of issues traded during a typical day on the New York Stock Exchange usually varies between 1,200 and 1,400.

BONDS AND DEBENTURES

224. At present, there are no bond or debenture issues listed on the Toronto Stock Exchange; all bond trading in Canada is done "over-the-counter". This has proven to be an efficient and satisfactory system and there seems little to be gained by the listing of bonds on the Exchange. In stock business done by members of the Toronto Stock Exchange, the broker ordinarily acts as an agent, whereas, in the bond business, the broker buys or sells as a principal. There is a substantial amount of bond trading carried on by bond houses who are not members of the Toronto Stock Exchange.

BONDS IN NEW YORK

225. At December 31, 1961, there were 1,186 bond issues listed on the New York Stock Exchange having a total par value of \$113 billion, comprised of 69% U.S. Government, New York State and City bonds, and 28% of United States company bonds. Bond trading volume on the New York Stock Exchange totalled \$1.6 billion during 1961. This would appear to be relatively small in relation to the total bond volume

transacted during the year.

LISTINGS ON THE T.S.E. BY TYPE OF INDUSTRY

226. See Appendix 26.

PROCEDURE AND REQUIREMENTS ON LISTING

227. The information and documents required to support an application for listing an "industrial" company is at Appendix 27 and, to support application for listing a mining, oil or natural gas company, at Appendix 28.

LISTING AGREEMENT AND FEES

228. (a) A copy of the listing agreement to be signed by listed companies is at Appendix 29.

(b) The listing fees of the Toronto Stock Exchange are set out in Appendix 30. The most noteworthy changes in recent years have been:

i) The introduction of an annual sustaining fee of \$100 in 1956. This fee was not made retroactive and now applies to somewhat less than one-third the listed companies.

ii) In 1960, the minimum listing fee for both mining and industrial listings was increased from \$1,000 to \$2,000.

iii) In 1962, revisions were made whereby a 50% credit could be given on the fees for listing the Canadian subsidiary of a foreign company provided the parent company had been listed on the Toronto Stock Exchange.

iv) In 1962, a reduction in the fees payable on a stock split and on large capitalizations, which favoured lower-priced industrial companies with large share issues.

NEW YORK FEES

229. The listing fees of the New York Stock Exchange are substantially higher than those of the Toronto Stock Exchange both on the initial listing fee and on the annual fee basis, as would be expected. The minimum initial listing fee is the same - \$2,000 - but the initial rate is one cent per share for the first 500,000 shares. The minimum continuing fee (payable for fifteen years) is \$500 and is at an initial rate of \$100 per 100,000 shares.

REGULATIONS GOVERNING LISTED COMPANIES

230. A copy of Exchange Circular No. 6 with summary of these regulations is at Appendix 31. It will be noted that these provide, inter alia:

(a) Company must give notice to the Exchange of any proposed option, underwriting, sale or issue of treasury shares (see Circular No. 5, Appendix 33);

(b) Company must provide an annual report and financial statement to its shareholders and to the Exchange;

(c) The Governors of the Exchange may at any time require a company to submit to the Board a financial statement;

(d) Mining, oil and gas producing companies must give notice to the Exchange of any proposed mortgage, etc., on its property or equipment;

(e) Company must give prompt notice to shareholders and the Exchange of any action with respect to dividends or rights, and give adequate time for European shareholders to exercise those rights;

(f) Company must complete and file an annual questionnaire;

(g) Company must give notice of any material change in the business or affairs of the company, e.g., (unless specifically exempted) change in Board of Directors; change in share ownership sufficient to affect control of the company; acquisition or disposition by the company of any mining or oil property or interest, or of shares in another company at a price in excess of \$25,000 payable otherwise than in shares of the company; a new management contract, etc.

ADEQUACY OF COMPANY REPORTING

231. In a brief submitted in 1956 to The Royal Commission on Canada's Economic Prospects, the Security Analysts' Association of Toronto stated "that it believed that individual investors, as well

as institutional investors, played an important role in the provision of capital to industrial companies, and that a better informed investing public would materially assist in the further growth and development of our country." In 1959, the Toronto Stock Exchange and the Montreal Stock Exchange wrote a letter (Appendix 32) to listed companies urging them to provide interim financial reports to shareholders in order that they might keep abreast of current financial and general corporate information of their company. In these briefs and letters, the Security Analysts and the two Stock Exchanges made certain definite recommendations which, if heeded by public companies generally, would have contributed substantially to the improvement of corporate reporting and to the enlightenment of shareholders and security analysts alike. A recent survey on financial reporting in Canada, however, bears out the fact that only a few of the companies acted upon these recommendations.

232. With some notable exceptions, Canadian public companies generally seem to fail to recognize their responsibility to shareholders and to see the immeasurable value a well-informed analyst plays in fostering new investor confidence in their securities. It is the Stock Exchange's view that it is inconsistent to encourage wider ownership of Canadian securities without encouraging more informative company reporting. Shareholders have a right to know about events and trends affecting their company when they are happening, and not a year later when the stock market has already discounted the news long in advance.

IMPORTANCE OF SECURITY ANALYST

233. Generally speaking, we can assume that most shareholders buy and sell shares on advice from their broker, investment counsellor or trust officer. A shareholder's confidence in his investment is primarily induced by what others in financial circles have to say about the company in which they are investing. Consequently, the most important medium for presenting a company's image to the shareholder is the security analyst, but, to obtain his favourable endorsement, the company must assume responsibility for issuing financial reports that are both more frequent and bold in their attempt at full

and plain disclosure of the affairs of the company. Shares of a company which provides inadequate information on which analysts and investors generally can base reasonable conclusions tend to act irrationally in the market place. This, in turn, tends to destroy confidence and limit investor acceptance of that company's securities.

INFORMATION REQUIRED FROM COMPANIES

234. The Canadian Institute of Chartered Accountants published results of a survey which they completed on the financial reporting of 300 Canadian public companies over a four-year period from 1957 to 1960. It is interesting to note from figures in the survey that, in the area of the particular recommendations made in the 1956 brief of the Security Analysts, there has been only a modest attempt on the part of companies to improve their reporting methods. We endorse the recommendations that were made in this brief and believe that they should be reiterated once again as being essential for inclusion in Interim and Annual Reports:

(a) As a general rule, companies should provide sales figures in order that a measure of comparison of company and industry trends may be established. The disclosure rate in Canada is not good, as cited by the fact that only 30% of the companies disclosed sales figures in 1960 compared with 29% in 1957. This is surprisingly low in comparison to U.S. companies as indicated by a survey of 600 companies in the United States, which showed that 98% disclosed their sales figures. It is also interesting to note that in 1960 only 45% of the Canadian companies issued supplementary financial data, a decrease from 51% in 1957.

(b) Companies should report their operations and those of their subsidiaries on a consolidated basis, identify their subsidiaries and set out the basis of consolidation. Again, however, only 74% of the companies consolidated all their subsidiaries in 1960, compared with 70% in 1957.

(c) All companies should provide two-year detailed comparative statements of all accounts in order to facilitate

the comparison of figures from one year to another. In 1960, approximately 58% of the companies provided statements in comparative form, compared with 50% in 1957.

(d) Companies should be required to disclose the nature of long-term lease commitments in the financial statements and in further detail in the accompanying notes. It is evident that in recent years, lease financing has become more and more popular as a means of financing a company's capital requirements. Of 68 firms in the survey known to be committed to long-term leases, 46 had not provided any information whatsoever.

(e) Companies must recognize that bare figures in financial statements tell only part of the story. Complete discussion of points which need clarifying is essential in order that there can be no misinterpretation of the facts.

(f) The issuance of Interim Reports is of fundamental importance in keeping shareholders and analysts currently informed of the affairs of the company. There is considerable room for improvement, however, for only 19% of the 300 companies surveyed produced interim financial statements.

UNITED STATES REQUIREMENTS

235. It is obvious from these few comparisons that the Canadian shareholder and security analyst is at a disadvantage from his U.S. counterpart in being able to arrive at a well-informed opinion, as the flow of information from Canadian public companies is not as adequate as it might be. In the United States, the Securities Act of 1933 requires that companies with listed securities issue annual and interim reports. Many companies recognizing the value of good shareholder relations have gone beyond the requirements of the Act.

RECOMMENDATIONS

236. The Toronto Stock Exchange suggests that the following recommendations would go a long way towards achieving what is

desired by shareholders and analysts alike in setting up a uniform standard of corporate reporting.

We suggest that legislation be effected under the jurisdiction of the federal and provincial Companies Acts and the provincial Securities Acts, establishing a high, uniform set of standards requiring full disclosure of the accounts of the company. We also suggest that it be made mandatory that companies provide Interim Reports in addition to their Annual Reports.

ANNUAL REPORT

237. The Annual Report should be comprehensive enough in its scope to enable one to relate the company's performance to industry as a whole and should include, where practicable and possible, among other things:

1. A complete consolidation of the accounts of the parent and subsidiary companies, the identity of each subsidiary and the basis of consolidation of each.
2. Two-year detailed Comparative Balance Sheets.
3. Two-year detailed Comparative Earnings Statement.
4. Detailed notes to the Balance Sheets and Earnings Statements.
5. Explanation of accounting methods.
6. Statement of Earned Surplus.
7. Annual Review of Operations.
8. Two-year Statistical Summary of Operations.
9. Source and Application of Funds.
10. Sales Breakdown.
11. Ten-year Comparative Statement of Income and Balance Sheet items.
12. Expenditures on Research.
13. Labour Relations.
14. Trend of Industry.
15. Officers and Directors.
16. Description of Outstanding Securities, Options, etc.
17. Lease Arrangements.
18. Description of Plants and Properties.

19. Summary of Products.

238. We would point out to the Commission that these recommendations have in the past been approved by the Financial Analysts Federation, recommended in previous briefs to The Royal Commission and legislated in the Securities Act of a foreign country. These recommendations are therefore not new, nor are they unreasonable demands to be made of Canadian public companies.

EXCHANGE REGULATION OR INTERVENTION

239. Frequently, one hears criticism of the Stock Exchanges for their failure to compel listed companies to issue quarterly reports and to disclose more detailed information - it is said that also in other ways the Exchange should exercise more control by either refusing to list or by suspending those now listed. There may be some ground for this criticism in some areas, but the Exchange is often in a quandary as to how far it should invade two distinct areas of responsibility:

(a) that of Government, and

(b) that of the shareholder.

LEGISLATION VS. REGULATION

240. If it is good for companies listed on one Exchange to issue quarterly reports, give particulars of directors, holdings and transactions in the company shares, etc., etc., is it not equally good for unlisted companies or for companies listed on another Exchange to do likewise? It is suggested that such matters should be the subject of study and possible legislation so that all companies in the jurisdiction should be subject to the same requirements. This legislation can be achieved by co-ordination of provincial Corporation or Security Law and by amendments to the Dominion Companies Act.

SHAREHOLDER ACTION OR EXCHANGE INTERVENTION

241. How far is one Exchange justified in standing in the shareholder's shoes and intervening, or attempting to intervene, in his company's affairs? The Toronto Stock Exchange does go a great way in this respect with regard to mining, oil or gas producing companies, but, even here, the Exchange must exercise careful judgment and discretion; it is impossible to know in most cases whether a deal

is "good" or "bad". The best that can be done is to compel complete disclosure and endeavour to ensure that the information disclosed has wide circulation. This we do through the filing statements referred to in Chapter 7, Part I.

TAKE-OVER BIDS

242. This is perhaps a suitable place to discuss methods of making "take-over bids", i.e., offers made by one person or corporation to purchase shares at a certain price and in a quantity sufficient to give the offeror control of the offeree company. These bids or offers can be broken down into two basic kinds:

- (a) Those where the officers and/or directors of the company whose shares are being sought have no prior knowledge of the bid, and
- (b) Where the officers and/or directors (or at least some of them) have advance warning of the intentions of the buyer and in some instances may have negotiated the terms of the bid.

243. (A) There is no legislation (and probably should be no legislation) which denies the right of an individual, group or company to make an offer for a block of shares on any terms or conditions which he (or they) may regard as appropriate. However, in the case of (a), it would seem to be the duty of the officers and/or directors of the company in question to adopt the following policy with regard to the take-over bid:

- (1) Recommend either acceptance or rejection of the offer on the part of the shareholders.
- (2) State their own individual intention with regard to the offer.
- (3) Provide shareholders with an up-to-date statement of the current position of their company, as well as some indication as to its future outlook.

(B) In the case of (b), where the officers and/or directors have advance information, it would seem that they have the following obligations to their shareholders:

- (1) Insist, if possible, on the bid being made on a pro rata basis for all shares. (Note: This would apply

more particularly in the case of large public companies where a public offer for shares is made. It would not apply where a large or controlling block is purchased privately.)

(2) Insist, if possible, on the bid remaining open for a sufficient period of time to allow all shareholders to deposit their shares.

(3) Require, if possible, that if the offer is for cash, the buyer disclose his intentions with regard to the operation of the company in the future.

(4) Require that if the offer is an exchange of shares, as full information as possible concerning the "buying" company be made available.

(5) Recommend acceptance or rejection of the offer.

(6) State their own individual intentions with regard to the offer.

(7) Provide shareholders with an up-to-date statement of the current position of the company, as well as some indication as to its future outlook.

244. As to the buyer, it would seem that, generally speaking, his or its name should be disclosed; the offer should be left open for a reasonable period and shares deposited within that period should be allocated on a pro rata basis. But there may be, in some cases, good reason for not doing these things.

245. It must be appreciated that the Stock Exchange influence in this matter can extend only to those companies whose shares are listed on the Exchange, and there is some doubt as to the wisdom of imposing a method of action on such companies which might place them at a disadvantage vis-a-vis unlisted companies, including foreign companies. Nevertheless, it is the intention of the Toronto Stock Exchange to consult as soon as possible with other financial organizations which are interested or involved in the making and accepting of such offers (banks, trust companies and other Canadian stock exchanges) in an effort to evolve a code of procedure which will be acceptable to all of them and at the same time will not unduly embarrass or

restrict persons or companies in the conduct of their affairs.

246. The Toronto Stock Exchange considers that legislative action, probably by amendment of federal and provincial Companies Acts, is desirable in laying down a code of procedure to be applicable to all parties to such "bids" - provided, however, that enactment of the same code in all provinces and by the Federal Government should be simultaneous. Such amendments should be made only after most careful study and consultation with business and financial organizations. There seems to be general agreement that take-overs, mergers or amalgamations are an essential feature of economic growth and development, and care must be taken that the right to take such action is not unreasonably cribbed and hampered.

(Note: The Jenkins Committee Report on Company Law Revision in Great Britain, June 1962, paras. 265 to 294, pages 98 to 110, has interesting comments and recommendations on the subject of "take-overs".)

DIFFERENCE BETWEEN OVER-THE-COUNTER AND EXCHANGE TRADING

247. The basic difference between transactions on the Exchange and over-the-counter is that, in the case of the former, a common meeting ground is established for all attorneys to buy and sell, while, in the case of the unlisted market, transactions are finalized between brokers over the telephone, telex, by mail or any other means of communication available. This precludes any maintenance of formal records or quotations, and, as a consequence, any listings of quotations, volume highs, lows, or such pertinent information as may find its way into the daily press, must of necessity be at best an approximation. A typical trade in an over-the-counter mining or oil stock would proceed along the following lines.

METHOD OF TRADING

248. The broker receives an order to buy 1000 shares of X Gold Mines at 33 cents on a market which he has quoted as 32 Bid 34 Asked. Upon receipt of this order, his trader, drawing upon his experience and memory, begins to call brokers he knows to have an interest in this particular stock. He may, in his first call, complete this trade, or, at the end of his rounds, still have the order in hand and have nothing to show for his labours but the fact that he has identified himself to the street as a 33 Bidder for the other traders to store away in their memories for the future. Thus, unlike a common trading floor, where bids and offerings are a matter of common knowledge, the over-the-counter trader must be constantly in touch with other brokers, displaying his wares and receiving in return a run of such securities as the other dealers have for purchase or sale. If he consummates a trade, nothing is exchanged between principals but the word of the trader, which, with his background of experience, is the over-the-counter dealer's most treasured stock in trade. Member firms then clear the trade through their clearing house, and trades with non-members are qualified by exchange of contracts and subsequent deliveries are made under an informal rule, broadly based on Exchange regulations.

UNCERTAINTIES

249. While there is no guarantee that the client will buy his stock at the best offering or sell his stock at the best bid, an experienced trader will almost constantly achieve this in spite of the elements of dispersal which constantly militate against his trading. Dealings are frequently negotiated without regard to fixed spreads or amounts of stock, and the inexorable law of supply and demand applies at all times.

CHANGES IN THE UNLISTED MARKET LIST, 1935-1960

250. In previous cycles of the unlisted market, notably in the eras of 1935-8 and 1943-7, the market in mines, particularly, was broad, active and, at times, more vigorous and active than the listed market for this class of securities. A very close parallel today in content and volume would be the Canadian Stock Exchange. The unlisted mining market, however, began to decline around 1945, when a large number of companies contributing to the volume were accepted for listing, and finally came to an abrupt halt when the Ontario Securities Commission invoked new regulations calling for the sale of all classes of securities not listed on an approved exchange to take place by prospectus only. This led to still more listings, and to the sale of newly discovered mineral properties to already listed mining companies rather than the formation of new companies with what was considered the odious formality and expense of incorporation and distribution by prospectus. The practice of incorporating discoveries into already listed companies persists and, although the Toronto Stock Exchange has in recent years taken a long and searching look at listing applications, the present trend is to use the Canadian Stock Exchange and Vancouver Stock Exchange as distributing apparatus. The somewhat more liberal attitude of the Canadian Stock Exchange toward listings and, indeed, its vigorous solicitation of listings throughout the country, has encouraged this development.

PRESENT SITUATION IN UNLISTED MINES

251. At the present moment, perfunctory trading takes place in

hundreds of mining companies daily, but these consist almost entirely of unproven or semi-proven prospects which have been kept alive over the years in anticipation of successful operations or, as in the case of gold, the possibility of a rise in price.

UNLISTED INDUSTRIALS

252. As with mines and oils, the dealer in unlisted industrials acts as principal, prepared to buy or sell. Without his services, there would be no way for an investor to know the market value of his securities. He thus provides, to some degree, the "liquidity" which is more adequately and readily available to the listed securities through the facilities of the Exchange.

LIQUIDITY ESSENTIAL TO ATTRACT CAPITAL

253. Liquidity is an essential consideration to investors and, if no market quotation is available, the investing public will lose confidence in securities. This could lead to increased difficulty in securing the capital required for development of the Canadian economy. Dealers participating in the unlisted market must create buying interest when securities are offered for sale. Acting as a principal, they must be prepared to buy or sell a reasonable amount when quoting a market. Necessity and sound business practice dictates that when a purchase is made, buying interest must be generated on the part of either their own clients or through their contact with other dealers. This, of course, would not be necessary if a bid existed and was known to them. The operation of an unlisted trading department is costly, as it requires trained personnel and widespread communication facilities.

TWO DIVISIONS OF UNLISTED TRADING

254. There are two main divisions of the unlisted industrial market:

- (a) The first, which accounts for the majority of the total number of traded and the number of firms participating, is in the secondary market immediately following a new issue of securities. The major number of securities traded in this category are those where listing is contemplated. Usually, it is stated in the prospectus that application

will be made for listing. This phase of trading makes a valuable contribution to the successful distribution of the securities. After the initial placing of a new issue, there is, as a rule, a sufficient amount available to the market to warrant maintaining a consistent market. This particularly applies to those issues that sell at a premium immediately after issue. There have, however, been cases of the supply available to the market being at a discount from the original issue price due to liquidation by members of the selling group or distress selling by original investors. Another important supply of securities to this market is that part of a security sold in the form of a unit containing common shares or warrants to purchase common shares. The number of dealers who participate in this secondary market activity varies and usually decreases as the activity declines.

(b) The second division of the unlisted or over-the-counter market is made up of those dealers who maintain a continuous market on certain unlisted securities. In this category fall those securities such as Insurance Companies, Trust and Loan Companies and Industrial Securities. In all such cases, there is no announced intention to list.

TYPICAL SPREADS FOR DIFFERENT CLASSES OF EQUITY

255. The spread between the bid and ask price for unlisted securities is primarily dependent on the volume of trading. In active markets with considerable volume, the spread may be lowered to one quarter point. If the volume should decline, this spread may be increased to as much as two points or more if firm markets are quoted. It must be remembered that quoting unlisted markets involves liability, as the dealer is acting as a principal in most cases.

TRADING AS BETWEEN CANADIANS AND NON-RESIDENTS

256. There would be considerable variation in this category. There are comparatively few Canadian unlisted securities that are consistently traded with non-residents, and an accurate estimate is

difficult to make. It is our opinion that a rough guess would be 10%.

TRADING AS BETWEEN INDUSTRIALS AND MINES AND OILS

257. Statistics are not available to assess accurately the relative importance of over-the-counter trading in either industrials or mines and oils. It is our opinion that the volume would be considerably higher in the number of daily trades in mining issues, but this would not necessarily apply to an aggregate of dollar volume over a period of one year.

SIZE OF TYPICAL TRANSACTION

258. The principal division involved in this question would be between industrial and mining shares. In the case of the former and where the price of the equity is within the range of \$5.00 and \$50.00, the average transaction would be between 500 shares and 200 shares, dependent on price.

TRENDS AND THEIR IMPLICATIONS

259. Insufficient information is available in connection with share and dollar volume, number of issues, etc., in the over-the-counter market to establish past, or project future, trends. In the opinion of the Exchange, the over-the-counter market fulfills a function with respect to certain types of shares which are not suitable - or not yet ready - for listing, and may be expected to continue to perform that function in the future.

IMPORTANCE OF UNLISTED TRADING

260. The importance of the function of the unlisted industrial market should be recognized, and it follows that, as the number of issues placed with investors increases, the trading facilities should also increase. Unless it is recognized that there is an obligation on the part of underwriting firms to later provide a market for the securities placed with the public, an important part of the mechanism by which capital may change hands will be missing. This will be a contributing factor to the increased cost of obtaining capital. The price the borrower of capital funds has to pay through issuing non-liquid instruments is evidenced in the mortgage fields. The necessity of making these instruments liquid is now recognized.

REGULATION OF OVER-THE-COUNTER
TRADING PRACTICES

261. Too much emphasis has been given to the placing of issues with the public in the primary market without proper allocation of some part of the resulting profit to the maintaining of trading departments whose duty it will be to provide secondary markets. There is a close association of interest between members of the stock exchanges and members of the I.D.A. of C. It is therefore important that any form of regulation of trading practices be considered in the light of its effect on a dealer acting either as a member of the stock exchange or the I.D.A. of C., etc. One example would be the difference of regulations governing the margin requirements for unlisted securities.

